

No. 16010 ✓

United States
Court of Appeals
for the Ninth Circuit

GENE O. CLARK and FAYE CLARK,
Petitioners,
vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Transcript of Record

In Two Volumes
VOLUME I.
(Pages 1 to 280, inclusive)

Petition to Review a Decision of The Tax
Court of the United States

FILED

AUG 17 1938

PAUL P. O'BRYEN, CLERK

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[Clerk's Note: When deemed likely to be of an important nature, errors or doubtful matters appearing in the original certified record are printed literally in *italic*; and, likewise, cancelled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible, an omission from the text is indicated by printing in *italic* the two words between which the omission seems to occur.]

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The Tax Court of the United States

Docket No. 48542

GENE O. CLARK,	Petitioner,
vs.	
COMMISSIONER OF INTERNAL REVENUE,	Respondent.

DOCKET ENTRIES

1953

May 18—Petition received and filed. Taxpayer notified. Fee paid.

May 20—Copy of petition served on General Counsel.

May 18—Request for Circuit hearing in Kansas City, Mo. filed by taxpayer. 5/25/53 granted.

May 18—Notice of appearance of Walter L. McVey, Jr. as counsel filed.

July 20—Motion for extension to Aug. 20, 1953 to file answer filed by G. C. 7/21/53 granted.

Aug. 18—Answer filed by G. C.

Aug. 25—Copy of answer served on taxpayer, Kansas City.

Oct. 1—Motion for extension of time to 11/2/53 to file reply, filed by taxpayer. Granted.

Nov. 2—Reply to answer filed by taxpayer. Copy served.

1954

Aug. 17—Motion to change place of hearing to Los Angeles, Calif. filed by taxpayer. 8/20/54 granted.

1954

Aug. 17—Motion to withdraw Walter L. McVey, Jr., as counsel filed. 8/20/54 granted.

Nov. 24—Hearing set Jan. 10, 1955, Los Angeles.

1955

Jan. 10 & 12—Hearing had before Judge Raum on petr's. motion for continuance. Motion for continuance granted, served and appearances of Thomas A. Baird and Alva C. Baird filed at hearing.

Jan. 21—Hearing set March 21, 1955, Los Angeles, Calif.

Jan. 24—Transcript of hearing 1/12/55 filed.

Mar. 28, 30 & 31—Hearing had before Judge Fisher & Apr. 1—on the merits on Petr's. oral motion to consolidate dkts. 48542, 48543 and 48544, granted; on Respdt's oral motion to amend pleadings—taken C.A.V. and on Petr's. written motion to amend petition, granted. Respdt. given 30 days (5/2/55) to reply.

Stip. of facts: memorandum re Plea of Nolo Contendere; Motion to amend petition and amendment to petition (copies served), filed at hearing. Briefs 6/30/55 and Replies 8/1/55.

Apr. 18—Transcript of hearing 3/30/55 filed.

May 3—Transcript of hearing 3/28/55 filed.

Apr. 25—Transcript of hearing 3/31/55 filed.

Apr. 28—Answer to amendment to petition filed by G. C. 4/29/55 copy served.

1955

May 3—Transcript of hearing 4/1/55 filed.

Jun. 27—Motion for extension to Aug. 29, 1955 to file brief filed by G. C. 6/28/55 granted.

Aug. 24—Motion for extension of time to Oct. 13, 1955 to file brief, filed by G. C. 8/25/55 granted.

Sep. 26—Brief filed by taxpayer. 11/4/55 copy served.

Oct. 11—Motion for extension to Nov. 3, 1955 to file brief filed by G. C. 10/12/55 granted.

Nov. 3—Brief filed by G. C. Served 11/4/55.

Nov. 28—Motion for extension to Jan. 2, 1956 to file reply brief filed by respondent. 11/30/55 granted.

Dec. 1—Motion for extension to Jan. 18, 1956 to file reply brief filed by taxpayer. 12/1/55 granted.

1956

Jan. 17—Reply brief filed by taxpayer. 1/18/56 copy served.

1957

July 17—Memorandum findings of fact and opinion filed, Fisher, J. Decision will be entered under Rule 50. Served 7/17/57.

Nov. 13—Agreed computation filed.

Nov. 20—Decision entered, Judge Fisher. Served 11/21/57.

1958

Feb. 10—Petition for review by U. S. Ct. of Ap. 9th filed by Petr.

1958

Feb. 14—Designation of contents of record on re-view filed.

Feb. 17—Acknowledgment of service of designation
filed.

Feb. 17—Proof of service of petition for review
filed.

Mar. 3—Order extending time for filing record on review and docketing pet. for review to May 11, 1958.

The Tax Court of the United States

Docket No. 48543

FAYE CLARK, Petitioner,

VS.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

DOCKET ENTRIES

[Note: Docket Entries in No. 48543 are the same as in Docket No. 48542 set out at page 3 of this printed record.]

[Title of Tax Court and Docket No. 48542.]

PETITION

The above named petitioner hereby petitions for a redetermination of the deficiency set forth by the Commissioner of Internal Revenue in his notice of deficiency (Bureau Symbols A:R:90D:LHP) dated

February 20, 1953, and as a basis for his proceeding alleges as follows:

1. The petitioner is an individual with residence at Clark's Buffalo Ranch, Independence, Kansas. During the years 1945, 1946 and 1947, petitioner was a resident of the State of California and the returns for the periods here involved were filed with the Collector of Internal Revenue at Los Angeles, California.

2. The notice of deficiency (a copy of which is attached and marked Exhibit "A") was mailed to petitioner on February 20, 1953.

3. The deficiency as determined by the Commissioner is in income taxes for the calendar years 1945, 1946 and 1947 in the amount of \$24,955.42, with a penalty of \$12,477.72, making a total of \$37,433.14, all of which amount is in controversy.

4. The determination of tax set forth in the said notice of deficiency is based upon the following errors:

(a) The Commissioner has erroneously assessed tax deficiencies for the years 1945, 1946 and 1947 more than three years after the returns were filed, contrary to the provisions of section 276 (a) of the Internal Revenue Code.

(b) The Commissioner has erroneously assessed tax deficiencies for the years 1945 and 1946 more than five years after the returns were filed, contrary to the provisions of section 276 (c) of the Internal Revenue Code.

(c) The Commissioner has erroneously added to the deficiency a penalty in the amount of \$12,477.72.

(d) No grounds or reasons are stated by the Commissioner for assessing the tax deficiencies beyond the period of limitation or for asserting the penalty in the amount of \$12,477.72. The petitioner contends that there was no intent to evade payment of income taxes for the years 1945, 1946 and 1947.

(e) In determining the taxable net income of the petitioner for the year 1946, the Commissioner has erroneously determined that petitioner received taxable dividends from Gene Clark, Inc., in the amount of \$44,227.13, petitioner's one-half under California Community Property Law being \$22,113.56, which it is alleged he failed to report in his income tax return for the calendar year 1946.

(f) In determining the taxable net income of the petitioner for the year 1947, the Commissioner has erroneously determined that petitioner received taxable dividends from Gene Clark, Inc., in the amount of \$49,500.99, petitioner's one-half under California Community Property Law being \$24,750.50, which it is alleged he failed to report in his income tax return for the calendar year 1947.

5. The facts upon which petitioner relies as the basis of this proceeding are as follows:

(a) That to the best of petitioner's knowledge, the corporation of Gene Clark, Inc., paid out of its earned surplus only one legally declared dividend to petitioner. This dividend was in the amount of \$19,996.17, paid on or about April 30, 1948, and was reported by petitioner as taxable income in his tax return for that calendar year.

6. The petitioner is without adequate knowledge

or facts, at this time, to defend himself against the contentions of the Commissioner for the deficiency assessed for the years 1946 and 1947 for the following reasons:

(a) Petitioner's personal records, books of account, receipts, cancelled checks, check stubs, and deposit slips for the years 1946 and 1947 were delivered into the hands of a representative of The Bureau of Internal Revenue residing in Rosemead, California, by the name of Earl Stutzman, who petitioner believes examined said records upon the basis of an informer's report in order to determine whether or not any deficiencies existed in connection with petitioner's income tax returns filed these years. These records were delivered into the possession of the said Earl Stutzman and were examined by the said Earl Stutzman during the months of January, February and March, 1949. Upon completion of his examination of petitioner's income tax returns for these years, the said Earl Stutzman made a "no-change" report. None of these personal records were ever returned to petitioner.

(b) Petitioner has been unable to have access to or to examine the corporate records of Gene Clark, Inc., in their entirety since he received notice of deficiency. After receiving notice of deficiency, petitioner made a trip to California with his attorney for the purpose of obtaining or examining the complete records of Gene Clark, Inc., in connection with this case; however, petitioner was denied this right.

(c) Petitioner has reason to believe that certain

possible witnesses for petitioner have been intimidated.

(d) The notice of deficiency is insufficient to inform petitioner wherein Commissioner's contentions lie in respect to unreported dividends allegedly received by petitioner.

7. In redetermining petitioner's tax liability for the year 1947, petitioner claims a loss from farm operations in the amount of \$4,199.81, which loss was not claimed on petitioner's tax return filed for that year.

Wherefore, petitioner prays that this Court may hear the proceeding and redetermine the tax of petitioner for the years 1945, 1946 and 1947 and any deficiency which may be due from petitioner for those years.

/s/ GENE O. CLARK,
Petitioner.

Duly Verified.

EXHIBIT "A"

Form 1234

U. S. Treasury Department
Office of the Director of Internal Revenue, Head,
Audit Division, 417 South Hill Street, Los
Angeles 13, California.

Feb. 20, 1953

In replying refer to: A:R:90D:LHP

Mr. Gene O. Clark

c/o Clark's Buffalo Ranch, Independence, Kansas

Dear Mr. Clark:

You are advised that the determination of your

Exhibit "A"—(Continued)

income tax liability for the taxable years ended December 31, 1945, 1946 and 1947, discloses a deficiency of \$24,955.42 and \$12,477.72 in penalty, as shown in the statement attached. Assessment of such deficiency or deficiencies has been made under the provisions of the internal revenue laws applicable to jeopardy assessments.

In accordance with the provisions of existing internal revenue laws notice is hereby given of the deficiency or deficiencies mentioned.

Within 90 days from the date of the mailing of this letter you may file a petition with The Tax Court of the United States, at its principal address, Washington 4, D. C., for a redetermination of the deficiency. In counting the 90 days you may not exclude any day unless the 90th day is a Saturday, Sunday or legal holiday in the District of Columbia in which event that day is not counted as the 90th day. Otherwise Saturdays, Sundays and legal holidays are to be counted in computing the 90-day period.

Very truly yours,

T. COLEMAN ANDREWS,
Commissioner,

/s/ By R. A. RIDDELL,
Director.

Enclosures:

Statement
Form 1276

Exhibit "A"—(Continued)

Statement

A:R:90D:LHP

Mr. Gene O. Clark
c/o Clark's Buffalo Ranch
Independence, Kansas

Tax Liability for the Taxable Years Ended December 31, 1945, December 31, 1946 and December 31, 1947.

Summary of Deficiencies

Year		Deficiency	50% Penalty
1945	Income tax	\$ 803.89	\$ 401.95
1946	Income tax	12,052.82	6,026.41
1947	Income tax	12,098.71	6,049.36
Totals		\$24,955.42	\$12,477.72

Summary of assessments made under the provisions of Internal Revenue laws applicable to jeopardy assessments, on December 24, 1952, for the taxable years ended December 31, 1945, December 31, 1946 and December 31, 1947.

Year	Deficiency	50% Penalty	Interest Due 12-24-52
1945	Income tax \$ 803.89	\$ 401.95	\$ 326.76
1946	Income tax 12,052.82	6,026.41	4,176.05
1947	Income tax 12,098.71	6,049.36	3,466.03
Totals		\$24,955.42	\$12,477.72
			\$7,968.84

This determination of your income tax and penalty liability has been made upon the basis of information on file in this office.

The 50 per cent penalty shown herein has been asserted in accordance with the provisions of section 293(b) of the Internal Revenue Code.

Adjustments to Net Income

Taxable Year Ended December 31, 1945

Net income as disclosed by return	\$5,504.71
Additional income and unallowable deduction:	
(a) Net profit from business increased	\$2,500.00
(b) Net loss from sale of property	
other than capital assets disallowed	177.87
Net income adjusted	\$8,182.58

Exhibit "A"—(Continued)

Explanation of Adjustments

(a) It has been determined that you realized a net profit of \$17,365.16 from operation of your business, in lieu of \$12,365.16, the amount reported in your return, an increase of \$5,000.00, your community half of which is \$2,500.00.

(b) The deduction of \$355.75 claimed from the sale of property other than capital assets is disallowed. It has been determined that the property sold was your personal automobile, the loss from the sale of which is not an allowable deduction. Your community half of the amount disallowed is \$177.87.

Computation of Tax

Taxable Year Ended December 31, 1945

Net income adjusted	\$8,182.58	
Less: Surtax exemptions	1,500.00	
	<hr/>	
Surtax net income	\$6,682.58	
Surtax		\$1,564.77
Net income adjusted	\$8,182.58	
Less: Normal-tax exemption	500.00	
	<hr/>	
Net income subject to normal tax	\$7,682.58	
Normal tax at 3%		\$ 230.48
Correct income tax liability		\$1,795.25
Income tax liability shown on return, account No. 3051314		991.36
		<hr/>
Deficiency of income tax		\$ 803.89
50% Penalty		\$ 401.95

Adjustments to Net Income

Taxable Year Ended December 31, 1946

Net income as disclosed by return	\$14,651.67
Additional income:	
(a) Dividends unreported	22,113.56
	<hr/>
Net income adjusted	\$36,765.23

Explanation of Adjustments

(a) It has been determined that you received taxable dividends from Gene Clark, Inc., in the amount of \$44,227.13, your one-half \$22,113.56, which you failed to report in your income tax return for the calendar year 1946.

Exhibit "A"—(Continued)

Computation of Tax

Taxable Year Ended December 31, 1946

Net income adjusted	\$36,765.23
Less: Exemptions	1,500.00
<hr/>	
Balance, subject to surtax and normal tax	\$35,265.23
Tentative tax	\$16,582.40
Less 5%	829.12
<hr/>	
Correct income tax liability	\$15,753.28
Income tax liability shown on return, account No. 3039848	\$ 3,700.46
<hr/>	
Deficiency of income tax	\$12,052.82
50% Penalty	\$ 6,026.41

Adjustments to Net Income

Taxable Year Ended December 31, 1947

Net income as disclosed by return	\$ 9,130.51
Additional income:	
(a) Dividends unreported	24,750.50
<hr/>	
Total	\$33,881.01
Reduction of income:	
(b) Long-term capital gain decreased	99.80
<hr/>	
Net income adjusted	\$33,781.21

Explanation of Adjustments

(a) It has been determined that you received taxable dividends from Gene Clark, Inc., in the amount of \$49,500.99, your one-half \$24,750.50, which you failed to report in your income tax return for the calendar year 1947.

(b) It has been determined that a long-term capital gain of \$105.15 was realized by you from the sale of a residence acquired in November, 1946, in lieu of \$304.75, the amount reported in your return, a decrease of \$199.60, your community half of which is \$99.80.

Exhibit "A"—(Continued)

Computation of Alternative Tax
Taxable Year Ended December 31, 1947

Net income adjusted	\$33,781.21
Less: Excess of net long-term capital gain over net short-term capital loss	530.71
Ordinary net income	\$33,250.50
Less: Exemptions	1,500.00
Balance, subject to surtax and normal tax	\$31,750.50
Total tentative tax	\$14,305.31
Less 5%	715.27
Partial tax	\$13,590.04
Plus: 50 per cent of \$530.71	265.36
Alternative tax	\$13,855.40

Computation of Tax
Taxable Year Ended December 31, 1947

Net income adjusted	\$33,781.21
Less: Exemptions	1,500.00
Balance, subject to surtax and normal tax	\$32,281.21
Total tentative tax	\$14,642.79
Less 5%	732.14
Total normal tax and surtax	\$13,910.65
Alternative tax	\$13,855.40
Correct income tax liability	\$13,855.40
Income tax liability shown on return, account No. 3050798	\$ 1,756.69
Deficiency of income tax	\$12,098.71
50% Penalty	\$ 6,049.36

Served May 20, 1953.

[Endorsed]: T.C.U.S. Filed May 18, 1953.

[Title of Tax Court and Docket No. 48542.]

ANSWER

Comes now the Commissioner of Internal Revenue, by his attorney, Kenneth W. Gemmill, Acting Chief Counsel, Bureau of Internal Revenue, and for answer to the petition filed in the above-entitled proceeding, admits, denies, alleges, and avers as follows:

1. Admits the allegations of paragraph 1.

2. Admits the allegations of paragraph 2.

3. Admits the deficiencies as determined by the Commissioner are in income taxes and penalties for the calendar years 1945, 1946, and 1947. Denies the remaining allegations of paragraph 3. Avers the deficiencies in income tax and penalties as shown in the notice of deficiency are as follows:

Year	Deficiency	50% Penalty
1945 Income tax	\$ 803.89	\$ 401.95
1946 Income tax	12,052.82	6,026.41
1947 Income tax	12,098.71	6,049.36
	<hr/>	<hr/>
	\$24,955.42	\$12,477.72

4. (a) to (f), inclusive. Denies the allegations of error of paragraph 4 (a) to (f), inclusive.

5. (a) Denies the allegations of paragraph 5 (a).

6. (a) Denies the allegations of paragraph 6 (a).

(b) Denies the allegations of paragraph 6 (b).

(c) Denies the allegations of paragraph 6 (c).

(d) Denies the allegations of paragraph 6 (d).

7. Denies the allegations of paragraph 7.

8. Denies generally and specifically each and

every allegation contained in the petition not hereinbefore expressly admitted, qualified, or denied.

9. Further answering the petition, respondent affirmatively alleges that petitioner is liable for the 50 per cent fraud penalties imposed under the provisions of section 293(b) of the Internal Revenue Code for the taxable years 1945, 1946, and 1947 in the respective amounts of \$401.95, \$6,026.41, and \$6,049.36, as determined by the Commissioner and set forth in the notice of deficiency, a copy of which is attached to the petition. In support of the Commissioner's determination of the fraud penalties as set forth in said notice of deficiency respondent alleges as follows:

(a) During the taxable years 1945, 1946, and 1947 petitioner was married to Faye Clark and they lived together as husband and wife and were residents of the State of California.

(b) The petitioner caused to be prepared and filed with the Collector of Internal Revenue for the Sixth District of California his federal income tax returns for the taxable years 1945, 1946, and 1947 and represented that each of such returns was a true, correct, and complete return.

(c) In truth and in fact each of said income tax returns filed by petitioner for the taxable years 1945, 1946, and 1947 was false and fraudulent. The petitioner's net taxable income and the resulting income tax due thereon were understated in each such return as follows:

Year	Net Income Reported by Petitioner	Tax Liability Reported by Petitioner	Petitioner's Actual Net Income	Petitioner's Correct Tax Liability
1945	\$ 5,504.71	\$ 991.36	\$ 8,182.58	\$ 1,795.25
1946	14,651.67	3,700.46	36,765.23	15,753.28
1947	9,130.51	1,756.69	33,781.21	13,855.40

(d) At the time the aforesaid income tax returns for the taxable years 1945, 1946, and 1947 were prepared and filed the petitioner knew that such returns were false and fraudulent and that the amount of the taxable net income reported therein and the resultant tax liability shown thereon were understated in each of said returns. The petitioner knowingly, willfully, and fraudulently made and filed his federal income tax returns for the taxable years 1945, 1946, and 1947 with intent to deceive respondent and evade tax.

(e) During the taxable years 1945, 1946, and 1947 petitioner derived and received taxable income from a plumbing contracting business and/or dividend income from Gene Clark, Inc., which he failed to report for federal income tax purposes.

(f) On his income tax return for 1945 petitioner reported net income of \$5,504.71 whereas his correct net income for 1945 was \$8,182.58. The understatement of net income for 1945 consisted of unreported net income from his plumbing contracting business and the overstatement of a claimed deduction for a net loss from the sale or exchange of a Packard automobile.

(g) On his income tax return for 1946 petitioner reported net income of \$14,651.67 whereas his cor-

rect net income for 1946 was \$36,765.23. The understatement of net income for 1946 consisted of unreported taxable dividend distributions received by petitioner from Gene Clark, Inc.

(h) On his income tax return for 1947 petitioner reported net income of \$9,130.51 whereas his correct net income for 1947 was \$33,781.21. The understatement of net income for 1947 consisted of unreported taxable dividend distributions received by petitioner from Gene Clark, Inc. In determining the deficiency for 1947 the Commissioner reduced petitioner's taxable income by the sum of \$99.80 representing his community share of the overstatement of a long-term capital gain realized from the sale of a residence.

(i) The understatement of net income and income tax liability for each of the years 1945, 1946, and 1947 was due to fraud with intent to evade tax.

(j) Petitioner having filed false and fraudulent returns with intent to evade tax for each of the taxable years 1945, 1946, and 1947 neither the assessment nor collection of the proposed deficiencies is barred by any statute of limitations under the provisions of section 276(a) of the Internal Revenue Code.

10. Further answering the petition, for an alternative defense, respondent alleges that the five-year period of limitation is applicable under section 275(c) of the Internal Revenue Code for assessment and collection of the income tax deficiency

determined by the Commissioner in the amount of \$12,098.71 for 1947 as set forth in his said notice of deficiency. In support of such determination, respondent alleges and relies upon the following facts:

(a) On March 15, 1948 petitioner filed his federal income tax return for 1947 with the Collector of Internal Revenue for the Sixth District of California, reporting gross income of \$9,603.51, whereas in truth and in fact petitioner's gross income for such year totaled not less than \$34,281.20.

(b) Petitioner improperly omitted from gross income for the year 1947 an amount properly includible therein which is in excess of 25 per centum of the amount of gross income stated in the return and the period of limitation upon assessment and collection of the income tax deficiency for the taxable year 1947 had not expired at the time the Commissioner of Internal Revenue mailed his notice of deficiency to petitioner on February 20, 1953 asserting an income tax deficiency for such year.

Wherefore, it is prayed:

1. That the petitioner's appeal be denied and the respondent's determination be approved.

2. That The Tax Court redetermine the correct amounts of deficiencies to be equal to the amounts determined by the Commissioner in his notice of deficiency, namely, \$803.89 for 1945, \$12,052.82 for

1946, and \$12,098.71 for 1947 and that such deficiencies are due to fraud with intent to evade tax.

3. That The Tax Court enter its decision that petitioner knowingly, willfully, and fraudulently prepared and filed his income tax returns for each of the taxable years 1945, 1946, and 1947 with intent to deceive respondent and evade tax and that the 50 per cent fraud penalties of \$401.95 for 1945, \$6,026.41 for 1946, and \$6,049.36 for 1947 imposed under the provisions of section 293(b) of the Internal Revenue Code, attach.

4. That The Tax Court find and hold that the assessment and collection of the proposed deficiencies for the taxable years 1945, 1946, and 1947 are not barred by any statute of limitations under the provisions of section 276(a) of the Internal Revenue Code.

5. In the alternative, that The Tax Court enter its decision that for the taxable year 1947 petitioner improperly omitted from gross income an amount properly includible therein which is in excess of 25 per cent of the amount of gross income stated in the return; that for the year 1947 the five-year period of limitation for assessment and collection of the income tax deficiency for such year attaches pursuant to section 275(c) of the Internal Revenue Code; that the Commissioner's notice of deficiency dated February 20, 1953 was timely mailed to petitioner; and that the assessment and collection of

said income tax deficiency for the year 1947 is not barred.

/s/ KENNETH W. GEMMILL, WBS,
Acting Chief Counsel, Bureau of
Internal Revenue.

Of Counsel: John A. Gilmore, Regional Counsel,
Gene W. Reardon, Acting Appellate Counsel,
William B. Springer, Acting Assistant Appellate Counsel, Marvin E. Hagen, Special Attorney, Bureau of Internal Revenue.

[Endorsed]: T.C.U.S. Filed August 18, 1953.

[Title of Tax Court and Docket No. 48542.]

REPLY

Comes now the above named petitioner by his attorney, Walter L. McVey, Jr., in reply to the Answer of Respondent and denies each and every averment, statement and allegation of new matter therein contained.

Wherefore said Petitioner renews the prayer contained in his original pleading.

/s/ WALTER L. McVEY, JR.,
Counsel for Petitioner.

[Endorsed]: T.C.U.S. Filed November 2, 1953.

[Title of Tax Court and Docket No. 48542.]

MOTION TO AMEND PETITION

Now comes the petitioner and asks leave of Court to amend the petition in this proceeding for the purpose of establishing a loss in farming operations in the State of Kansas for the years 1946 and 1947, in the respective amounts of \$1,085.27 and \$4,874.91, and for the purpose of claiming an overpayment in taxes for the years 1945, 1946 and 1947, in the respective amounts of \$361.75, \$5,423.91 and \$5,444.42, or for overpayments in such other amounts as the Court may determine to have been made. The proposed amendment is hereinafter attached.

The basis of this Motion is as follows:

(1) In compiling income tax returns for the years 1946 and 1947 in Los Angeles, California, the petitioner overlooked a loss on certain farming operations conducted by him in Montgomery County, Kansas, in the respective amounts of \$1,085.27 and \$4,874.91. This matter did not come to the attention of counsel of record in this proceeding until after this proceeding had been scheduled for trial before the Court on the Court's Calendar commencing March 21, 1955. Counsel then examined certain bank accounts relating to said farming operations and obtained from a firm of certified public accountants in Independence, Kansas, certain work papers and data relating to the operations of said farm, all of which information has been exhibited to and discussed with representatives of the Re-

spondent and has been made available to the Internal Revenue Agent sent to the offices of counsel for the petitioner for the purpose of examining said data and information. Counsel for respondent was, before the commencement of the trial on this proceeding, fully apprised of the nature of petitioner's data and information pertaining to said losses and will in no way be prejudiced by the granting of said motion.

(2) The petitioner on or about January 14, 1954, paid to the Director of Internal Revenue at Wichita, Kansas, the sums of \$361.75, \$5,423.91, and \$5,444.42, to apply against a jeopardy assessment which had been made against her on December 24, 1952. These payments and the receipt thereof have been stipulated by written stipulation on file in this proceeding. The taxes reported on the individual returns of the petitioner for the years 1945, 1946, and 1947 have been paid. The Director of Internal Revenue at Los Angeles, California, has furnished counsel for respondent an official certification to this effect.

Respectfully submitted,

/s/ ALVA C. BAIRD,

Counsel for Petitioners.

Of Counsel: Thomas A. Baird, Frank W. Mahoney.

Served April 1, 1955.

[Stamped]: Granted April 1, 1955. Morton P. Fisher, Judge.

[Endorsed]: T.C.U.S. Filed April 1, 1955.

[Title of Tax Court and Docket Nos. 48542-3.]

AMENDMENT TO PETITION

Paragraph 5 of the petition is amended by adding subparagraph (d), as follows:

(d) During the calendar years 1946 and 1947 petitioners Gene O. Clark and Faye Clark were operating a farm for the production of grain in Montgomery County, Kansas; that said farm was acquired on or about July, 1946; that the crops planted in that year to mature in the Spring of 1947 were destroyed by flood; that by reason of the fact that petitioners raised no crop in 1946 and by reason of the fact that the crop planted in 1946 was destroyed as aforesaid in 1947, petitioners had no income from said operations for either 1946 or 1947. Petitioners did expend in said farm operations the amounts of \$2,170.53 and \$9,749.82. Said expenses were incurred in the ordinary course of business and are a proper deduction in determining the petitioners' tax liability for the years 1946 and 1947. One-half of the total amounts spent should be allocated to each petitioner.

The prayer of the petitioners is amended to read as follows:

Petitioners pray that the Court determine there is no deficiency in tax for the years 1945, 1946 and 1947, and that there is an overpayment for each of said years in the respective amounts set out in the following schedule:

Year	Gene Clark	Faye Clark
1945.....	\$ 361.75	\$ 370.80
1946.....	5,423.91	5,470.80
1947.....	5,444.42	5,513.79

Respectfully submitted,

/s/ ALVA C. BAIRD.

Of Counsel: Thomas A. Baird, Frank W. Mahoney.

Served April 1, 1955.

[Endorsed]: T.C.U.S. Filed April 1, 1955.

[Title of Tax Court and Docket No. 48542.]

ANSWER TO AMENDMENT TO PETITION

The Commissioner of Internal Revenue, by his attorney, R. P. Hertzog, Acting Chief Counsel, Internal Revenue Service, for answer to the amendment to petition of the above-named taxpayer, denies as follows:

5. Denies all the allegations contained in subparagraph (d) of paragraph 5 of the amendment to petition.

Wherefore it is prayed that the determination of the Commissioner be approved.

/s/ R. P. HERTZOG, REM,

Acting Chief Counsel, Internal
Revenue Service.

Of Counsel: Melvin L. Sears, Regional Counsel,
E. C. Crouter, Assistant Regional Counsel,
R. E. Maiden, Jr., Special Assistant to the Regional Counsel, Sidney J. Machtinger, Attorney, Internal Revenue Service.

Served April 29, 1955.

[Endorsed]: T.C.U.S. Filed April 28, 1955.

[Title of Tax Court and Docket No. 48543.]

PETITION

The above named petitioner hereby petitions for a redetermination of the deficiency set forth by the Commissioner of Internal Revenue in his notice of deficiency (Bureau Symbols A:R:90D:LHP) dated February 20, 1953, and as a basis for his proceeding alleges as follows:

1. The petitioner is an individual with residence at Clark's Buffalo Ranch, Independence, Kansas. During the years 1945, 1946 and 1947, petitioner was a resident of the State of California and the returns for the periods here involved were filed with the Collector of Internal Revenue at Los Angeles, California.

2. The notice of deficiency (a copy of which is attached and marked Exhibit "A") was mailed to petitioner on February 20, 1953.

3. The deficiency as determined by the Commissioner is in income taxes for the calendar years 1945, 1946 and 1947 in the amount of \$25,234.09, with a penalty of \$12,617.06, making a total of \$37,851.15, all of which amount is in controversy.

4. The determination of tax set forth in the said notice of deficiency is based upon the following errors:

(a) The Commissioner has erroneously assessed tax deficiencies for the years 1945, 1946 and 1947 more than three years after the returns were filed, contrary to the provisions of section 276 (a) of the Internal Revenue Code.

(b) The Commissioner has erroneously assessed tax deficiencies for the years 1945 and 1946 more than five years after the returns were filed, contrary to the provisions of section 276 (c) of the Internal Revenue Code.

(c) The Commissioner has erroneously added to the deficiency a penalty in the amount of \$12,617.06.

(d) No grounds or reasons are stated by the Commissioner for assessing the tax deficiencies beyond the period of limitation or for asserting the penalty in the amount of \$12,617.06. The petitioner contends that there was no intent to evade payment of income taxes for the years 1945, 1946 and 1947. During these years, petitioner was married to Gene O. Clark; however, she took no part nor did she have any knowledge of his business operations. Any income which petitioner may have received during this period was solely by reason of the Community Property Law of the State of California.

(e) In determining the taxable net income of the petitioner for the year 1946, the Commissioner has erroneously determined that petitioner's husband received taxable dividends from Gene Clark, Inc., in the amount of \$44,227.13, petitioner's one-half under California Community Property Law being \$22,113.57, which it is alleged she failed to report in her income tax return for the calendar year 1946.

(f) In determining the taxable net income of the petitioner for the year 1947, the Commissioner has erroneously determined that petitioner's husband received taxable dividends from Gene Clark, Inc., in the amount of \$49,500.99, petitioner's one-half

under California Community Property Law being \$24,750.49, which it is alleged she failed to report in her income tax return for the calendar year 1947.

5. The facts upon which petitioner relies as the basis of this proceeding are as follows:

(a) That to the best of petitioner's knowledge, the corporation of Gene Clark, Inc., paid out of its earned surplus only one legally declared dividend to petitioner's husband, Gene O. Clark. This dividend was in the amount of \$19,996.17, paid on or about April 30, 1948, and was reported as taxable income by petitioner and her husband in their joint tax return for that calendar year.

6. The petitioner is without adequate knowledge or facts, at this time, to defend herself against the contentions of the Commissioner for the deficiency assessed for the years 1946 and 1947 for the following reasons:

(a) While petitioner shared in the property of her husband, Gene O. Clark, under the Community Property Law of the State of California during the periods here involved, she never took an active part in the business or financial affairs of her husband, and therefore has no records or books of account from which she can contest the contentions of the Commissioner.

(b) Petitioner has been unable to have access to or to examine the corporate records of Gene Clark, Inc., in their entirety since she received notice of deficiency. After receiving notice of defi-

ciency, petitioner's attorney made a trip to California for the purpose of obtaining or examining the complete records of Gene Clark, Inc., in connection with this case; however, petitioner's attorney was denied this right.

(c) The notice of deficiency is insufficient to inform petitioner wherein Commissioner's contentions lie in respect to unreported dividends allegedly received by petitioner's husband, one-half of which dividends were allegedly received by petitioner as her share of the community property.

Wherefore, petitioner prays that this Court may hear the proceeding and redetermine the tax of petitioner for the years 1945, 1946 and 1947 and any deficiency which may be due from petitioner for those years.

/s/ FAYE CLARK,
Petitioner.

Duly Verified.

EXHIBIT "A"

Form 1234

U. S. Treasury Department
Office of the Director of Internal Revenue, Head,
Audit Division, 417 South Hill Street, Los
Angeles 13, California. Feb. 20, 1953

In replying refer to: A:R:90D:LHP.

Mrs. Faye Clark
c/o Clark's Buffalo Ranch, Independence, Kansas.

Dear Mrs. Clark:

You are advised that the determination of your

Exhibit "A"—(Continued)

income tax liability for the taxable years ended December 31, 1945, 1946 and 1947, discloses a deficiency of \$25,234.09 and \$12,617.06 in penalty, as shown in the statement attached. Assessment of such deficiency or deficiencies has been made under the provisions of the internal revenue laws applicable to jeopardy assessments.

In accordance with the provisions of existing internal revenue laws notice is hereby given of the deficiency or deficiencies mentioned.

Within 90 days from the date of the mailing of this letter you may file a petition with The Tax Court of the United States, at its principal address, Washington 4, D. C., for a redetermination of the deficiency. In counting the 90 days you may not exclude any day unless the 90th day is a Saturday, Sunday or legal holiday in the District of Columbia in which event that day is not counted as the 90th day. Otherwise Saturdays, Sundays and legal holidays are to be counted in computing the 90-day period.

Very truly yours,

T. COLEMAN ANDREWS,
Commissioner,

/s/ By R. A. RIDDELL,
Director.

Enclosures:

Form 1276
Statement

Exhibit "A"—(Continued)

Statement

A:R:90D:LHP

Mrs. Faye Clark
c/o Clark's Buffalo Ranch
Independence, Kansas

Tax Liability for the Taxable Years Ended December 31, 1945, December 31, 1946 and December 31, 1947.

Summary of Deficiencies

Year	Deficiency	50% Penalty
1945 Income tax	\$ 823.89	\$ 411.95
1946 Income tax	12,157.33	6,078.67
1947 Income tax	12,252.87	6,126.44
Totals	\$25,234.09	\$12,617.06

Summary of assessments made under the provisions of Internal Revenue laws applicable to jeopardy assessments, on December 24, 1952, for the taxable years ended December 31, 1945, December 31, 1946 and December 31, 1947.

Year	Deficiency	50% Penalty	Interest to 12/24/52
1945 Income tax	\$ 823.99	\$ 411.95	\$ 334.89
1946 Income tax	12,157.33	6,078.67	4,212.26
1947 Income tax	12,252.87	6,126.44	3,510.19
Totals	\$25,234.09	\$12,617.06	\$8,057.34

This determination of your income tax and penalty liability has been made upon the basis of information on file in this office.

The 50 per cent penalty shown herein has been asserted in accordance with the provisions of section 293(b) of the Internal Revenue Code.

Adjustments to Net Income

Taxable Year Ended December 31, 1945

Net income as disclosed by return	\$5,504.71
Additional income and unallowable deduction:	
(a) Net profit from business increased \$2,500.00	
(b) Net loss from sale of property	
other than capital assets disallowed	177.87
	2,677.87
Net income adjusted	\$8,182.58

Exhibit "A"—(Continued)

Explanation of Adjustments

(a) It has been determined that your husband realized a net profit of \$17,365.16 from operation of his business, in lieu of \$12,365.16, the amount reported in your return, an increase of \$5,000.00, your community half of which is \$2,500.00.

(b) The deduction of \$355.75 claimed from the sale of property other than capital assets is disallowed. It has been determined that the property sold was your personal automobile, the loss from the sale of which is not an allowable deduction. Your community half of the amount disallowed is \$177.87.

Computation of Tax

Taxable Year Ended December 31, 1945

Net income adjusted	\$8,182.58	
Less: Surtax exemptions	1,000.00	
	<hr/>	
Surtax net income	\$7,182.58	
Surtax		\$1,714.77
Net income adjusted	\$8,182.58	
Less: Normal-tax exemption	500.00	
	<hr/>	
Net income subject to normal tax	\$7,682.58	
Normal tax at 3%		\$ 230.48
		<hr/>
Correct income tax liability		\$1,945.25
Income tax liability shown on return, account No. 3056461		\$1,121.36
		<hr/>
Deficiency of income tax		\$ 823.89
50% Penalty		\$ 411.95

Adjustment to Net Income

Taxable Year Ended December 31, 1946

Net income as disclosed by return	\$14,651.66
Additional income:	
(a) Dividends unreported	22,113.57
	<hr/>
Net income adjusted	\$36,765.23

Explanation of Adjustments

(a) It has been determined that your husband received taxable dividends from Gene Clark, Inc., in the amount of \$44,-

Exhibit "A"—(Continued)

227.13, your one-half \$22,113.57, which you failed to report in your income tax return for the calendar year 1946.

Computation of Tax

Taxable Year Ended December 31, 1946

Net income adjusted	\$36,765.23
Less: Exemptions	1,000.00
<hr/>	
Balance, subject to surtax and normal tax	\$35,765.23
Tentative tax	\$16,907.40
Less 5%	845.37
<hr/>	
Correct income tax liability	\$16,062.03
Income tax liability shown on return, account No. 3039847	3,904.70
<hr/>	
Deficiency of income tax	\$12,157.33
50% Penalty	6,078.67

Adjustments to Net Income

Taxable Year Ended December 31, 1947

Net income as disclosed by return	\$ 9,130.51
Additional income:	
(a) Dividends unreported	24,750.49
<hr/>	
Total	\$33,881.00
Reduction of income:	
(b) Long-term capital gain decreased	99.80
<hr/>	
Net income adjusted	\$33,781.20

Explanation of Adjustments

(a) It has been determined that your husband received taxable dividends from Gene Clark, Inc., in the amount of \$49,500.99, your one-half \$24,750.49, which you failed to report in your income tax return for the calendar year 1947.

(b) It has been determined that a long-term capital gain of \$105.15 was realized by you from the sale of a residence acquired in November, 1946, in lieu of \$304.75, the amount reported in your return, a decrease of \$199.60, your community half of which is \$99.80.

Exhibit "A"—(Continued)

Computation of Alternative Tax
Taxable Year Ended December 31, 1947

Net income adjusted	\$33,781.20
Less: Excess of net long-term capital gain over net short-term capital loss	530.71
Ordinary net income	\$33,250.49
Less: Exemptions	1,000.00
Balance, subject to surtax and normal tax	\$32,250.49
Tentative Tax	\$14,622.82
Less 5%	731.14
Partial tax	\$13,891.68
Plus: 50 per cent of \$530.71	265.35
Alternative tax	\$14,157.03

Computation of Tax
Taxable Year Ended December 31, 1947

Net income adjusted	\$33,781.20
Less: Exemptions	1,000.00
Balance, subject to surtax and normal tax	\$32,781.20
Tentative tax	\$14,967.78
Less 5%	748.39
Total normal tax and surtax	\$14,219.39
Alternative tax	\$14,157.03
Correct income tax liability	\$14,157.03
Income tax liability shown on return, account No. 3050797	1,904.16
Deficiency of income tax	\$12,252.87
50% Penalty	\$ 6,126.44

Served May 20, 1953.

[Endorsed]: T.C.U.S. Filed May 18, 1953.

[Title of Tax Court and Docket No. 48543.]

ANSWER

Comes now the Commissioner of Internal Revenue, by his attorney, Kenneth W. Gemmill, Acting Chief Counsel, Bureau of Internal Revenue, and for answer to the petitioner filed in the above-entitled proceeding, admits, denies, alleges, and avers as follows:

1. Admits the allegations of paragraph 1.

2. Admits the allegations of paragraph 2.

3. Admits the deficiencies as determined by the Commissioner are in income taxes and penalties for the calendar years 1945, 1946, and 1947. Denies the remaining allegations of paragraph 3. Avers the deficiencies in income tax and penalties as shown in the notice of deficiency are as follows:

Year	Deficiency	50% Penalty
1945 Income tax	\$ 823.89	\$ 411.95
1946 Income tax	12,157.33	6,078.67
1947 Income tax	12,252.87	6,126.44
	<hr/>	<hr/>
	\$25,234.09	\$12,617.06

4. (a) to (f), inclusive. Denies the allegations of error of paragraph 4 (a) to (f), inclusive.

5. (a) Denies the allegations of paragraph 5 (a).

6. (a) Denies the allegations of paragraph 6 (a) except it is admitted that petitioner shared in the property of her husband, Gene O. Clark under the Community Property Law of the State of California during the periods here involved.

(b) Denies the allegations of paragraph 6 (b).

(c) Denies the allegations of paragraph 6 (c).

7. Denies generally and specifically each and every allegation contained in the petition not hereinbefore expressly admitted, qualified, or denied.

8. Further answering the petition, respondent affirmatively alleges that petitioner is liable for the 50 per cent fraud penalties imposed under the provisions of section 293 (b) of the Internal Revenue Code for the taxable years 1945, 1946, and 1947 in the respective amounts of \$411.95, \$6,078.67, and \$6,126.44 as determined by the Commissioner and set forth in the notice of deficiency, a copy of which is attached to the petition. In support of the Commissioner's determination of the fraud penalties as set forth in the said notice of deficiency, respondent alleges as follows:

(a) During the taxable years 1945, 1946, and 1947 petitioner was married to Gene O. Clark and they lived together as husband and wife and were residents of the State of California.

(b) The petitioner caused to be prepared and filed with the Collector of Internal Revenue for the Sixth District of California her Federal income tax return for the taxable years 1945, 1946 and 1947 and represented that each of such returns was a true, correct, and complete return.

(c) In truth and in fact each of said income tax returns filed by petitioner for the taxable years

1945, 1946, and 1947 was false and fraudulent. The petitioner's net taxable income and the resulting income tax due thereon were understated in each such return as follows:

Year	Net Income Reported by Petitioner	Tax Liability Reported by Petitioner	Petitioner's Actual Net Income	Petitioner's Correct Tax Liability
1945	\$ 5,504.71	\$1,121.36	\$ 8,182.58	\$ 1,945.25
1946	14,651.66	3,904.70	36,765.23	16,062.03
1947	9,130.51	1,904.16	33,781.20	14,157.03

(d) At the time the aforesaid income tax returns for the taxable years 1945, 1946, and 1947 were prepared and filed the petitioner knew that such returns were false and fraudulent and that the amount of the taxable net income reported therein and the resultant tax liability shown thereon were understated in each of the said returns. The petitioner knowingly, willfully, and fraudulently made and filed her federal income tax returns for the taxable years 1945, 1946, and 1947 with intent to deceive respondent and evade tax.

(e) During the taxable years 1945, 1946, and 1947 petitioner derived and received taxable income from a plumbing contracting business and/or dividend income from Gene Clark, Inc., which she failed to report for federal income tax purposes.

(f) On her income tax return for 1945 petitioner reported net income of \$5,504.71 whereas her correct net income for 1945 was \$8,182.58. The understatement of net income for 1945 consisted of unreported net income from a plumbing contracting business and the overstatement of a claimed

deduction for a net loss from the sale or exchange of a Packard automobile.

(g) On her income tax return for 1946 petitioner reported net income of \$14,651.66 whereas her correct net income for 1946 was \$36,765.23. The understatement of net income for 1946 consisted of unreported taxable dividend distributions received by petitioner from Gene Clark, Inc.

(h) On her income tax return for 1947 petitioner reported net income of \$9,130.51 whereas her correct net income for 1947 was \$33,781.20. The understatement of net income for 1947 consisted of unreported taxable dividend distributions received by petitioner from Gene Clark, Inc. In determining the deficiency the Commissioner reduced petitioner's taxable income by the sum of \$99.80 representing her community share of the overstatement of a long-term capital gain realized from the sale of a residence.

(i) The understatement of net income and income tax liability for each of the years 1945, 1946, and 1947 was due to fraud with intent to evade tax.

(j) Petitioner having filed false and fraudulent returns with intent to evade tax for each of the taxable years 1945, 1946, and 1947 neither the assessment nor collection of the proposed deficiencies is barred by any statute of limitations under the provisions of section 276(a) of the Internal Revenue Code.

9. Further answering the petition, for an alter-

native defense, respondent alleges that the five-year period of limitation is applicable under section 275 (c) of the Internal Revenue Code for assessment and collection of the income tax deficiency determined by the Commissioner in the amount of \$12,252.87 for 1947 as set forth in his said notice of deficiency. In support of such determination, respondent alleges and relies upon the following facts:

(a) On March 15, 1948 petitioner filed her federal income tax return for 1947 with the Collector of Internal Revenue for the Sixth District of California, reporting gross income of \$9,630.51 whereas in truth and in fact petitioner's gross income for such year totaled not less than \$34,281.20.

(b) Petitioner improperly omitted from gross income for the year 1947 an amount properly includible therein which is in excess of 25 per centum of the amount of gross income stated in the return and the period of limitation upon assessment and collection of the income tax deficiency for the taxable year 1947 had not expired at the time the Commissioner of Internal Revenue mailed his notice of deficiency to petitioner on February 20, 1953 asserting an income tax deficiency for such year.

Wherefore, it is prayed:

1. That the petitioner's appeal be denied and the respondent's determination be approved.
2. That the Tax Court redetermine the correct

amounts of deficiencies to be equal to the amounts determined by the Commissioner in his notice of deficiency, namely, \$823.89 for 1945, \$12,157.33 for 1946 and \$12,252.87 for 1947 and that such deficiencies are due to fraud with intent to evade tax.

3. That the Tax Court enter its decision that petitioner knowingly, willfully, and fraudulently prepared and filed her income tax returns for each of the taxable years 1945, 1946, and 1947 with intent to deceive respondent and evade tax and that the 50 per cent fraud penalties of \$411.95 for 1945, \$6,078.67 for 1946, and \$6,126.44 for 1947 imposed under the provisions of section 293(b) of the Internal Revenue Code, attach.

4. That the Tax Court find and hold that the assessment and collection of the proposed deficiencies for the taxable years 1945, 1946, and 1947 are not barred by any statute of limitations under the provisions of section 276(a) of the Internal Revenue Code.

5. In the alternative, that the Tax Court enter its decision that for the taxable year 1947 petitioner improperly omitted from gross income an amount properly includible therein which is in excess of 25 per cent of the amount of gross income stated in the return; that for the year 1947 the five-year period of limitation for assessment and collection of the income tax deficiency for such year attaches pursuant to section 275(c) of the Internal Revenue Code; that the Commissioner's notice of deficiency dated February 20, 1953 was timely

mailed to petitioner; and that the assessment and collection of said income tax deficiency for the year 1947 is not barred.

/s/ KENNETH W. GEMMILL, WBS
Acting Chief Counsel,
Bureau of Internal Revenue.

Of Counsel: John A. Gilmore, Regional Counsel,
Gene W. Reardon, Acting Appellate Counsel,
William B. Springer, Acting Assistant Appellate Counsel, Marvin E. Hagen, Special Attorney, Bureau of Internal Revenue.

[Endorsed]: T.C.U.S. Filed August 18, 1953.

[Title of Tax Court and Docket No. 48543.]

REPLY

Comes now the above named Petitioner by her attorney, Walter L. McVey, Jr., in reply to the Answer of Respondent and denies each and every averment, statement and allegation of new matter therein contained.

Wherefore said Petitioner renews the prayer contained in her original pleading.

/s/ WALTER L. McVEY, JR.,
Counsel for Petitioner.

[Endorsed]: T.C.U.S. Filed November 2, 1953.

[Title of Tax Court and Docket No. 48543.]

MOTION TO AMEND PETITION

Now comes the petitioner and asks leave of the Court to amend the petition in this proceeding for the purpose of establishing a loss in farming operations in the State of Kansas for the years 1946 and 1947, in the respective amounts of \$1,085.26 and \$4,874.91, and for the purpose of claiming an overpayment in taxes for the years 1945, 1946 and 1947, in the respective amounts of \$370.80, \$5,470.80 and \$5,513.79, or for overpayments in such other amounts as the Court may determine to have been made. The proposed amendment is hereinafter attached.

The basis of this Motion is as follows:

(1) In compiling income tax returns for the years 1946 and 1947 in Los Angeles, California, the petitioner overlooked a loss on certain farming operations conducted by her in Montgomery County, Kansas, in the respective amounts of \$1,085.26 and \$4,874.91. This matter did not come to the attention of counsel of record in this proceeding until after this proceeding had been scheduled for trial before the Court on the Court's Calendar commencing March 21, 1955. Counsel then examined certain bank accounts relating to said farming operations and obtained from a firm of certified public accountants in Independence, Kansas, certain work papers and data relating to the operations of said farm, all of which information has been exhibited to and discussed with representatives of the

Respondent and has been made available to the Internal Revenue Agent sent to the offices of counsel for the petitioner for the purpose of examining said data and information. Counsel for respondent was, before the commencement of the trial on this proceeding, fully apprised of the nature of petitioner's data and information pertaining to said losses and will in no way be prejudiced by the granting of said motion.

(2) The petitioner on or about January 14, 1954, paid to the Director of Internal Revenue at Wichita, Kansas, the sums of \$370.80, \$5,470.80, and \$5,513.79 to apply against a jeopardy assessment which had been made against her on December 24, 1952. These payments and the receipt thereof have been stipulated by written stipulation on file in this proceeding. The taxes reported on the individual returns of the petitioner for the years 1945, 1946 and 1947 have been paid. The Director of Internal Revenue at Los Angeles, California, has furnished counsel for respondent an official certification to this effect.

Respectfully submitted,

/s/ ALVA C. BAIRD,

Counsel for Petitioners.

Of Counsel: Thomas A. Baird, Frank W. Mahoney.

[Stamped]: Granted April 1, 1955. Morton P. Fisher, Judge.

Served April 1, 1955.

[Endorsed]: T.C.U.S. Filed April 1, 1955.

[Title of Tax Court and Docket No. 48543.]

ANSWER TO AMENDMENT TO PETITION

The Commissioner of Internal Revenue, by his attorney R. P. Hertzog, Acting Chief Counsel, Internal Revenue Service, for answer to the amendment to petition of the above-named taxpayer, denies as follows:

5. Denies all the allegations contained in subparagraph (d) of paragraph 5 of the amendment to petition.

Wherefore it is prayed that the determination of the Commissioner be approved.

/s/ R. P. HERTZOG, REM,
Acting Chief Counsel, Internal
Revenue Service.

Of Counsel: Melvin L. Sears, Regional Counsel,
E. C. Crouter, Assistant Regional Counsel,
R. E. Maiden, Jr., Special Assistant to the
Regional Counsel, Sidney J. Machtinger, At-
torney, Internal Revenue Service.

Served April 29, 1955.

[Endorsed]: T.C.U.S. Filed April 28, 1955.

The Tax Court of the United States

Docket Nos. 48542-3-4

MINUTES OF PROCEEDINGS

Date: March 28, 30, 31, April 1, 1955. Place: Los Angeles, Calif.

Proceeding: Gene O. Clark et al.

Assigned to Judge Morton P. Fisher. Division No. 15.

Counsel For Petitioner: Alva A. Baird, Esq., Thomas A. Baird, Esq., 458 South Spring St., Los Angeles 13, California. For Respondent: Sidney Machtinger, Esq., Earl J. Gardner, Esq.

Stenographic Reporters: Frances Way, Herbert Aaisness.

Hearing: March 28, 30, 31, SUB. Transcript Ordered: Yes.

On the merits: Yes. On oral motion of petitioners for consolidation. No objection. Oral motion of resp. to amend pleadings to conform to proof. Written motions to amend petitions by petitioner.

Ordered: Consolidation Granted. Oral mot. of resp. to amend pleadings. CAV. Written motions to amend petitions by pet. Granted. Respondent given 30 days to file reply or to move thereto. (30 days would fall on May 2, 1955.)

Filed at hearing: Stip. of Facts: Memorandum re Plea of Nolo Contendere. 48542, Motion to Amend Petition (served 4/1/55). 48543, Motion to Amend Petition (served 4/1/55). 48542, 48543,

Amendment to Petition (served 4/1/55). 48544, Motion to Amend (served 4/1/55).

Simultaneous briefs: 90 days, June 30, 1955.
30 days, August 1, 1955.

Witnesses for Petitioner: Parris P. Claypool, Gene Clark.

Witnesses for Respondent: Y. L. Creed, Truman Johnson, Ben Lang, Frances E. Bittinger, Lloyd George Meissenburg, Jack P. Hudson, Frederick W. Files, Donald P. Phillips, Kenneth S. Stutzman.

Petitioner's Exhibits:

- 1-A—RAR Gene O. Clark;
- 2-B—RAR Gene O. and Faye Clark;
- 3-C—RAR Gene Clark, Inc.;
- 4-D—1945 Return Gene O. Clark;
- 5-E—1946 Return Gene O. Clark;
- 6-F—1947 Return Gene O. Clark;
- 7-G—1945 Return Faye Clark;
- 8-H—1946 Return Faye Clark;
- 9-I—1947 Return Faye Clark;
- 10-J—1948 Return Gene O. Clark and Faye Clark—also amended return;
- 11-K—1949 Return Gene O. and Faye Clark;
- 12-L—1947 Return Gene Clark, Inc.;
- 13-M—1948 Return Gene Clark, Inc.;
- 14-N—1949 Return Gene Clark, Inc.;
- 15—Gene Clark, Inc. Fiscal 1947 Analysis of Income Available for Distribution to Stockholders Bases on Report of RA, D. E. Phillips;
- 16—Fiscal 1947 Gene O. Clark, Inc. Comparative Analysis of Surplus Based Upon Report of Exam-

ination by RA Don E. Phillips and 90 day Letter Showing Amount Available for Distribution as a Constructive Dividend;

17—Gene Clark, Inc. Balance Sheets;

18—Gene Clark, Inc. Disposition of Income Reported in Return Fiscal Year April 30, 1947;

19—General Ledger (4 sheets) Record of Journal Entries (3 sheets);

See Koyl case for exhibits:

20-WW—RAR Gene Clark, Inc.;

21-XX—Cash Receipts Unidentified FYE 1950 Gene Clark, Inc.;

22-YY—Cash Receipts Unidentified FYE 1949 Gene Clark, Inc.;

23-ZZ—Cash Receipts Unidentified FYE 1948 Gene Clark, Inc.;

24-AAA—Cash Receipts Not Located in Deposits FYE 1947 Gene Clark, Inc.;

25—Map;

26—Minutes (10 sheets);

27—Agreement dated Jan. 28, 1949;

28—Affirmation of sale;

29—Assumption of Obligation 3/29/48;

30—Note 98077 2/5/48;

31—Note 98076 2/5/48;

32—Check 4602 \$450.00;

33—Check 4605 \$102.15;

34—Check 4606 \$274.95;

35—Check 4607 \$50.00;

36—Check 4608 \$50.00;

37—Check 4609 \$50.00;

- 38—Check 4610 \$20.00;
 - 39—Check 4612 \$50.00;
 - 40—Check 4613 \$50.00;
 - 41—Check 4614 \$195.57;
 - 42—Check 4615 \$50.00;
 - 43—Check 4616 \$50.00;
 - 44—Check 4617 \$50.00;
 - 45—Check 4618 \$36.50;
 - 46—Check 4619 \$590.36;
 - 47—Check 4620 \$50.00;
 - 48—Check 4603 \$50.00;
 - 49—MFI (offered but not admitted) Income Tax Schedule;
 - 50—Check 4621 \$50.00;
 - 51—Check 4622 \$85.00;
 - 52—Check 4623 \$50.00;
 - 53—Check 4624 \$50.00;
 - 54—Check 4627 \$50.00;
 - 55—MFI only;
 - 56—Receipt Montgomery Taxes;
 - 57—Cert. of Payments and Assessment (3 sheets).
- Respondent's Exhibits:
- O—Affidavit of Y. L. Creed;
 - P—Check No. 11 Y. L. Creed;
 - Q—Plumbing Contract;
 - R—Plumbing Contract;
 - S—Check 3008 Ben Lang;
 - T—Invoice (2) Ben Lang;
 - U—Check No. 1534 Hamilton Homes, Statement dated 8/14/47, Invoice 8/14/47;

V—Check No. 1476 Hamilton Homes, Statement 7/9/47;

W—Check No. 1539 Hamilton Homes, Invoice dated 2/11/47, Invoice dated 8/26/47, Heaters on Tract Invoice 9/9/46, Invoice 8/29/46;

X—Check No. 52, 68, Invoice Sept. 10, 1947;

Y—Check No. 3787;

Z—(This letter not used);

AA—Checks 2936, 212, 3351, 3696, 4587, 659, 581, Valley City Supply Co. Invoice 3351, 3696, 4587, 442, 212, Statement Invoice 1/16/47, Invoice 1/18/47, Valley City Supply Invoice—Delivered to Valley Cities;

BB—Check No. 537807, Check No. 537806, Check No. 392991, 394131, 395227, 392653;

CC—Check No. 2313 Mitchell & Son;

DD—Check No. 866, Invoice Jan. 21, 1948;

EE—Check No. 2346;

FF—Receipt No. 5493, 5492, 5494, 5491;

GG—Southern California Investment Co.;

HH—Loss on Sale of Property other than Capital;

A—Assets May 1, 1947-April 30, 1948;

II—Receipt Sept. 16, 1947;

JJ—Hamilton Homes (4 sheets);

KK—Journal Entries Folio 18;

LL—Check No. 16510 Valley Blvd. Plumbing & Electric Co.;

MM—Check No. 16561 Valley Blvd. Plumbing & Electric Co.;

NN—Recap of Material Purchased and Payment Made From Merssenberg's record;

OO—Photostat Receipt 3/2/48;

PP—MFI (offered but not admitted) FyE 4/30/47 Gene Clark Inc. Adjustment to Net Income and Distribution to Shareholders;

QQ—MFI only (offered but not admitted) Stipulation of deficiency Gene Clark, Inc.;

RR—Story & Sons 1948;

SS—Gene Clark, Inc. Sale of Business Assets 5/1/47 to 4/30/48;

TT—Check No. 1774 A&F Plumbing & Heating Co., 3 invoices (Receipted);

UU—Check No. 1167, 1188, 1160, 1273, Victor Kinsel;

VV—J. M. Young Dr. Cr. Acc. Rec. Adv.;

BBB—Bank Statement George Meissenbuerg, Statement;

CCC—Judgment & Commitment.

/s/ PATRICK CASEY,
Deputy Clerk.

T. C. Memo. 1957-129

Tax Court of the United States

Gene O. Clark, Petitioner, v. Commissioner of Internal Revenue, Respondent.

Faye Clark, Petitioner, v. Commissioner of Internal Revenue, Respondent.

Gene O. Clark and Faye Clark, Husband and Wife, Petitioners, v. Commissioner of Internal Revenue, Respondent.

Docket Nos. 48542, 48543, 48544.¹

Filed July 17, 1957.

MEMORANDUM FINDINGS OF FACT AND OPINION

Petitioner Gene O. Clark, president and majority stockholder of Gene Clark, Inc., from April 23, 1946, through March 1, 1949, inclusive, was the dominating factor in conducting and controlling its corporate affairs. The corporation received substantial amounts of taxable income from unrecorded sales which it failed to report on its returns. Peti-

¹ The instant case presents some issues similar to those involved in *Archie M. Koyl, et al., v. Commissioner*, Docket Nos. 48336, 48337, 48338, in which case Findings of Fact and Opinion are filed simultaneously herewith. The proceedings in the two cases have not been consolidated. It has been stipulated, however, that there shall be incorporated as evidence into the record in the instant case, so far as relevant, all of the testimony material herein given by revenue agent Donald E. Phillips, and exhibits relating thereto, in the Koyl case, *supra*. There is, however, specifically excluded from consideration in the instant proceeding the stipulations in the Koyl

tioner withheld and diverted to his own purposes substantial amounts out of the proceeds of such unreported sales.

Held:

1. Petitioners realized unreported income from informal or constructive dividends from Gene Clark, Inc., for the calendar years 1946 and 1947, reportable for income tax purposes on the community property basis. Farm losses determined for 1946 and 1947. Long-term capital gain for 1947 adjusted. Unreported income determined for 1946 and 1947.

2. Petitioners did not understate taxable income in their joint returns for 1948 and 1949.

3. Petitioner Faye Clark's individual income tax returns for 1946 and 1947 were not false and fraudulent with intent to evade taxes. Assessment and collection as to Faye Clark barred by limitations as to the year 1946 but not as to the year 1947, because of omission from gross income in her return for that year of amounts properly includible therein which are in excess of 25 per centum of the amount of gross income stated in said return.

4. Each of the returns of Gene O. Clark for the

case relating to net income as adjusted, deficiencies and additions to tax for fraud of Gene Clark, Inc., for the fiscal years 1947 through 1950, inclusive, since the petitioners herein were not parties to said stipulations and petitioners' objection to their use has been sustained. What otherwise would appear to be inconsistent results stem from the material differences in the records of the respective cases as presented to us, including differing stipulations of fact.

years 1946 and 1947 was false and fraudulent with intent to evade taxes.

5. A part of the deficiency of Gene O. Clark for each of the years 1946 and 1947 was due to fraud with intent to evade taxes. Additions to tax under section 293(b) of the Internal Revenue Code of 1949 are applied for said years.

Thomas A. Baird, Esq., and Alva C. Baird, Esq., for the petitioners.

Sidney Machtinger, Esq., and Earl J. Gardner, Esq., for the respondent.

Fisher, Judge: This consolidated proceeding involves deficiencies in income tax and additions to tax determined against petitioners as follows:

Petitioner	Year	Deficiency	Sec. 293(b) Additions to Tax
Gene O. Clark	1945	\$ 803.89	\$ 401.95
Gene O. Clark	1946	12,052.82	6,026.41
Gene O. Clark	1947	12,098.71	6,049.36
Faye Clark	1945	823.89	411.95
Faye Clark	1946	12,157.33	6,078.67
Faye Clark	1947	12,252.87	6,126.44
Gene O. Clark and Faye Clark	1948	19,780.57	9,890.29
Gene O. Clark and Faye Clark	1949	7,472.72	3,736.36

Claim to additions to tax with respect to petitioner Faye Clark for the calendar years 1946 and 1947 has been waived by respondent. The parties have stipulated that the year 1945 is not presently in issue and that there will be an overpayment of tax in such year, the amount thereof to be reflected in the Rule 50 computation. The parties also stipu-

lated that petitioners sustained a net operating loss during 1950 in the amount of \$4,513.62, and that said amount is properly allowable as a loss carry-back to the year 1949. Other stipulated adjustments between the parties will likewise be reflected in the Rule 50 computation.

The principal issues presented for our consideration are: (1) whether petitioners received constructive dividends for any of the years 1946 through 1949, inclusive, from Gene Clark, Inc., which they failed to report on their individual tax returns for 1946 and 1947 and their joint returns for 1948 and 1949, and, if so, in what amounts; (2) whether petitioners realized unreported capital gains for either or both of the years 1948 and 1949; (3) whether any part of the several deficiencies determined for each of the taxable years in issue was due to fraud with intent to evade tax; (4) whether assessment and collection of any of the deficiencies determined against Gene or Faye Clark for 1946 and 1947 are barred by the statute of limitations, and (5) whether petitioners sustained unallowed farm losses for the taxable years 1946 and 1947.

General Findings of Fact

The facts are partly stipulated and to the extent so stipulated are incorporated herein by reference.

Petitioners, Gene O. and Faye Clark, are husband and wife, and during the calendar years 1946, 1947 and 1948 resided in Los Angeles County, California. In March 1949, they moved to Independence, Kansas, and for the remainder of the year were resi-

dents of Kansas. All income derived by petitioners during the years 1946 to 1948, inclusive, was community income. For the calendar years 1946 and 1947, they filed separate income tax returns on the community property basis and for the calendar year 1948, they filed a joint return with the collector of internal revenue of Los Angeles, California. For the year 1949, they filed a joint income tax return with the collector of internal revenue for the district of Wichita, Kansas.

Prior to April 23, 1946, Gene O. Clark (hereinafter sometimes called petitioner) and Archie Koyl were associated in a business venture known as Gene Clark Plumbing Co. (hereinafter sometimes referred to as the Plumbing Co.), consisting of two shops, located in El Monte and Bell Gardens, California, and having a labor force of approximately 35 employees. The Plumbing Co. was engaged primarily in selling plumbing supplies and rendering plumbing services to building contractors. No certificate for doing business under a fictitious name was filed on behalf of Plumbing Co. to show that it was a partnership.

Petitioner and Archie Koyl organized a California corporation, Gene O. Clark, Inc., now known as Atlas Pipe and Supply Company (hereinafter sometimes called the corporation), on April 23, 1946,² to engage in the wholesale plumbing business.

² Although the parties repeatedly refer to the date of incorporation as May 1, 1946, the record shows that the official date of incorporation was April 23, 1946.

Of the 522 shares of \$100 par value stock authorized, 364 shares were issued to petitioner, president of the corporation, and 157 shares to Archie M. Koyl, vice president. One qualifying share was issued to another individual who is not involved herein. Petitioner acquired his shares at a cost of \$36,500. Petitioner's shares represented an ownership interest in said corporation of approximately 70 per cent.

On or about March 29, 1948, petitioner purchased the 157 shares of stock owned by Koyl for \$24,714.49. The sale of Koyl's interest therein was consummated by a document designated "Assumption of Obligation," dated March 29, 1948, filed as petitioners' Exhibit 29 and incorporated herein by reference.

Thereafter, in December 1948, Clark informed Koyl that he desired to sell out his entire interest in Gene Clark, Inc., to Koyl. On or about March 1, 1949, Clark sold all of his stock to the Koyls, 262 shares to Archie and 260 shares to Fawn, a total of 522 shares.

During the fiscal years ended April 30, 1947, to 1950, inclusive, the proportional stock ownership in Gene Clark, Inc., is summarized as follows:

Date	Clark	Koyl
April 23, 1946 to March 31, 1948	70%	30%
March 31, 1948 to March 1, 1949	100%	
March 1, 1949 to April 30, 1950		100% ³

³ Including shares of Fawn Koyl.

Gene Clark, Inc., commenced its business operations on or about April 23, 1946, occupying the same premises as the Plumbing Co. Within a few months after the formation of the corporation, the inventory of the Plumbing Co. and that of the corporation were commingled and were thereafter kept as a single unit. The only employees on the business premises were those of the corporation. No records were kept that could properly reflect business transactions of any plumbing enterprise other than the corporation. The only book kept in the office that had any connection with Plumbing Co. was a check book on the Bank of America in El Monte. No Federal tax returns were filed on behalf of Plumbing Co. for any period after April 23, 1946.

Plumbing Co. existed, however, for an indeterminate period after the organization of the corporation, solely for the purpose of buying and selling plumbing materials in violation of the then existent regulations of the Office of Price Administration (O.P.A.). This was done because Plumbing Co. did not hold any license to do business which could be forfeited if it were found guilty of violating O.P.A. regulations. Plumbing Co. was to serve as a front in such transactions for the corporation which did hold a license to do business.

The corporation kept its books on an accrual method and reported its income on a fiscal year basis beginning with the year ending April 30, 1947.

After incorporation of the plumbing enterprise, customers would frequently make out checks to

Gene Clark, to the corporation or to Plumbing Co. To obviate the resultant confusion, the corporation adopted a rubber stamp showing all three designations in order that it might properly endorse any check. This composite stamp was used throughout the period here in question.

During each of the taxable years in which Clark was an officer and stockholder of Gene Clark, Inc., substantial but undisclosed and undetermined amounts of receipts from sales made by the corporation were neither recorded on its books nor reported on its income tax returns. During the fiscal years involved herein, the net income of Gene Clark, Inc., reported on its returns (the tax liability of which is material here because of its reflection upon the issues involving petitioners) the total additions to its net income as found by the revenue agent, and its total net income as so found are as follows:⁴

Year	Net Income per Returns	Additions to Net Income per Revenue Agent's Report	Total Net Income per Revenue Agent's Report
1947	\$30,632.10	\$102,050.17	\$132,682.27
1948	16,726.40	92,208.62	108,935.02
1949	(4,154.03)	46,575.16	42,421.16

⁴ The additions to net income and the total net income here listed were predicated upon the computations contained in a report prepared by respondent's agent during the investigation of the income tax liability of Gene Clark, Inc., which report (discussed *infra*) was received in evidence by stipulation of the parties for the purpose of explaining the basis of respondent's ultimate determination, but not as evidence of the facts contained therein.

Joint Exhibits 3-C, 1-A, and 2-B, being, respectively, the revenue agent's reports on Gene Clark, Inc., for the fiscal years ending April 30, 1947-1949, inclusive; the petitioners' separate returns for 1945, 1946 and 1947; and petitioners' joint returns for 1948 and 1949, are incorporated herein by reference.

Up to March 1, 1949, (when he sold out his entire interest to the Koyls), petitioner was in general control of the over-all corporate operations and dictated its financial policies. Clark was in full charge of the main office in El Monte. Archie Koyl directed the activities at the shop in Bell Gardens. Virtually all other corporate activities, including the maintenance of corporate records and the disposition of receipts, were under the direct control of petitioner.

Fred Files, comptroller and office manager of the corporation, worked under the immediate supervision and direction of petitioner. Files' duties consisted primarily of handling receipts and keeping proper office records. He worked at both shops, keeping one set of books for the entire operation, though consecutively numbered duplicate receipt books were maintained in both shops. When cash was received from a customer, the amount thereof was recorded in the receipt book which was, in substance, merely a memorandum that was later transferred to the "cash receipts" journal in the books of account. Cash sales were sometimes totalled daily and sometimes only several times a week. A single "cash receipt" figure was usually recorded in the journal for the total amount of the separate sales.

Deposits of the total cash receipts were made in the corporation's bank account and generally recorded weekly in the cash receipts journal. Files, who handled all of the bank deposits of the corporation, regularly deposited all cash receipts of the corporation which were turned over to him for such purpose by Gene Clark. On a number of occasions, however, Gene instructed Files to set aside the cash proceeds from certain sales and to turn such funds over to him without recording the sales on the books. Also, at different times, petitioner would give Files checks made out to the corporation by customers for sales, which sales were unrecorded on the corporate books, in exchange for the cash taken by petitioner. An undetermined part of such cash proceeds were used by the officer-stockholder to cash checks as an accommodation for neighborhood stores and workmen in relatively small sums ranging up to \$100. There was a substantial but undetermined difference in the amount of cash Files recorded in corporate books or deposited in its bank accounts and the amount of cash sales actually made by the corporation. The aforementioned method of handling cash sales was also the general practice of Plumbing Co. and was not altered by the coming into existence of the corporation during the entire taxable period involved herein.

Between May 1946 and December 1946, petitioner, on behalf of the corporation, frequently sold and shipped plumbing materials from the El Monte yard without any entry being made for the transactions in the corporate records. Some of such ship-

ments represented "trading transactions" or non-profit exchanges of materials with competitors for mutual convenience.

Subsequent to December 1946, petitioner frequently sold and traded plumbing equipment on behalf of the corporation. He also sold and traded used vehicles. Files was not supplied with the appropriate sales slips and proceeds on many of these transactions. Sometimes Clark would simply give the comptroller a check, without adequate details connected with the sale, and instruct him to remove the particular asset from the corporate books.

During 1947, when maximum ceiling price regulations on plumbing supplies were in effect under the Office of Price Administration, Clark engaged in black market activities. When he dealt in such illicit activities, petitioner would generally pay an undisclosed amount of cash for the purchase of materials over the price indicated on the invoice. These cash funds were taken from unreported corporate receipts. The over-ceiling cash payment was not recorded on the corporate books as part of the total cost of the illicit purchases. Neither petitioner, Plumbing Co., nor the corporation reported the profits from such illegal sales transactions.

During each of the taxable years in question, petitioner also had an arrangement with Keenan Pipe and Supply Co. whereby he was able to purchase materials on behalf of the corporation at one-third off for cash. Under this arrangement, indeterminate amounts of such purchases were made and paid for (usually with receipts obtained from unre-

ported corporate sales), the parties agreeing not to keep any records of their cash transactions.

Apart from the foregoing *modus operandi* during each of the years involved herein, Gene Clark, Inc., made numerous purchases of plumbing materials in the normal course of business which were not recorded on the corporate books, but the subsequent sales thereof were likewise unrecorded. Also, in many instances, the profits from such sales were neither reported by the corporation on its income tax returns nor by petitioners on their returns for the years in issue. The corporation also rendered plumbing services for building contractors on a number of housing projects during the years in question, and petitioner failed to record the full receipts therefor on its books.

Y. L. Creed Transaction

Between December 1945 and March 1946, Gene Clark performed extensive plumbing work for Y. L. Creed, a general contractor, on four houses being constructed in Maywood, California. Creed agreed to pay a total of \$2,922.50 for such services, of which the first payment was made by a check in the sum of \$544, on February 5, 1946. The same day, the check for \$544 was deposited to the account of Gene Clark Plumbing Co., and recorded in the sales of that company. The remaining \$2,378.50 was credited to petitioner by Creed in June 1946, on account of the purchase price of a house (5957 Otis Avenue, Maywood, California) which petitioner purchased from him for a total consideration of \$8,500. The

balance of the purchase price was represented by a trust deed made out in favor of Creed and a cash payment of \$1,400 placed in escrow by Clark. The credit of \$2,378.50 was not reported on the income tax return of Gene Clark or Gene Clark, Inc. The Plumbing Co. filed no return for this period. See further Findings *infra*, paragraph (3) under heading "Matters Relating to Earnings and Profits available for Distribution."

Unreported Transactions—Gene Clark, Inc.

On October 5, 1946, Gene Clark, Inc., and Truman Johnson, a building contractor, executed a contract under which the corporation was to supply plumbing materials and services to Johnson on 10 new houses in West Covina, California. The contract price set forth in the written contract was \$3,300, but the actual price was \$9,300. (On January 22, 1947, the parties executed another contract for similar services on a housing project, consisting of 40 houses being built in West Covina at a cost of \$930 per house or a total of \$37,200.) About the same time it rendered these plumbing services to Johnson, Gene Clark, Inc., purchased a house from him for a total price of \$22,000. The price per unit of the 10 houses to be serviced under the October 5, 1946, contract was \$930 per house. The difference of \$6,000 between the written contract price of \$3,300 and the actual (though unexpressed) contract price of \$9,300 represented part payment on the house which the corporation purchased from Johnson. The corporation was credited by Johnson with the

difference of \$6,000 on the purchase of the house in 1946. Likewise, Johnson's books reflected the full cost of the materials and services furnished, including the \$6,000 in question. The transaction was handled in the foregoing manner at the request of petitioner. The \$6,000 credit was neither recorded on the books of Gene Clark, Inc., nor reported on the corporate income tax returns for any year involved herein. In September 1947, the corporation sold the house to Clark at an amount which was about \$3,137.90 less than the actual cost. The amount of the selling price to Clark was set up as an account receivable on the books of the corporation.

In the year 1947, the following amounts were received by Gene Clark, Inc., from Hamilton Homes, Inc., for plumbing material and services, which were not included in the sales of Gene Clark, Inc.:

Date	Amount
9/10/47	\$1,221.00
9/16/47	2,295.00
7/ 9/47	2,170.00

A receipt for \$8,241.42 dated September 16, 1947, was issued to Gene Clark with the notation "Payment in full for Equity in House at 1825 Vine," and the amount thereof was credited to Gene on the "Accounts Receivable — Officers" account of Gene Clark, Inc., by entry dated September 30, 1947. On September 16, 1947, (the same day the receipt for \$8,241.42 was issued to petitioner), the corporation made a bank deposit in its commercial bank account at Citizens National Bank of Maywood, California,

in the amount of \$21,180.51, which included, in addition to an undisclosed amount of cash, two of the three checks (in the respective amounts of \$1,221 and \$2,295) representing unrecorded sales received from Hamilton Homes, Inc. The third check for \$2,170 was deposited by the corporation on July 30, 1947, as part of a deposit in the amount of \$10,016.46. The three checks from Hamilton Homes, Inc., were substituted for other receipts from sales recorded on the corporate books but not deposited.

Gene Clark, Inc., received a check dated September 15, 1947, in the amount of \$1,000 from H. K. Niles, which was not reported in the corporate books as a sale, but was included in the corporation's bank deposit of September 16, 1947, mentioned above, in the amount of \$21,180.51. This check was likewise an item substituted for other sales recorded on the books but not deposited.

The following checks were also received by petitioner on behalf of the corporation for materials and plumbing services:

Payable to	Amount	Date	Payor
Gene Clark	\$2,294.50	1/14/48	Allen T. Mitchell & Son
Gene Clark Plumbing Co.	1,158.44	2/10/48	A. & F. Plumbing & Heating Co.
Gene Clark (endorsed "Gene Clark")	1,558.44	4/20/48	Ben Lang

It was stipulated that the above amounts were not entered on the books and records of the corporation as sales, nor were they reported for tax pur-

poses on the income tax returns of the corporation or of the petitioners for the years in issue.

It was likewise stipulated that during 1948, petitioner received the following amounts, totalling \$38,009.74, from Lloyd H. Meissenburg, of George A. Meissenburg (Valley Boulevard Plumbing & Electric Co.), plumbing contractors, for plumbing materials, which amounts also were not recorded in the corporate records or reported on the income tax returns of either Gene Clark, Inc., or the petitioners for any of the years involved herein:

Method of Payment	Date	Amount	Payable to	Endorsed by
Check	2/ 9/48	\$22,935.00	Gene Clark	Gene Clark
Check	1/29/48	3,074.74	Gene Clark	Gene Clark
Cash	3/ 2/48	12,000.00		

Of the total of \$38,009.74 received as above noted, Clark retained approximately 70 per cent and gave Koyl approximately 30 per cent.

A check in the amount of \$1,700, received by the corporation (made payable to Gene Clark) in payment for one of its vehicles, was drawn by Walter A. Story on February 12, 1948. There is no evidence in the record that the check was entered on the books of the company.

On March 4, 1948, petitioner received a check in the amount of \$6,670 from the Southern California Investment Company for rough plumbing (on some 23 houses at \$290 per unit) payable to Gene Clark, Inc. The check for \$6,670 was endorsed "Gene Clark, Inc., Gene Clark" and cashed March 19,

1948. A cashier's check in the amount of \$6,670 payable to Gene Clark, Inc., was acquired the same date and was deposited March 31, 1948, in the commercial bank account of Gene Clark, Inc., at Citizens National Bank, Maywood, as part of an overall deposit of \$12,816.85. The receipt of the \$6,670 was not recorded as a sale in the records of Gene Clark, Inc., nor was it reported as income by either the corporation or petitioners. The deposit of the cashier's check of \$6,670 was in substitution for other receipts recorded on the books of Gene Clark, Inc., but not deposited in the corporation's bank account.

On March 20, 1948, the day after the cashier's check was acquired, Gene Clark, Inc., received a total amount of \$6,610 in cash from the following four separate transactions, for each of which the corporation comptroller issued a cash receipt. The corporation received \$1,250 in cash from the sale of a 1947 Chevrolet truck. The transaction was reported in the corporation's return for fiscal year 1948 as a sale of assets. The amount of \$1,473.93 in cash was also received from Story and Sons and that sum was credited to their account on the books of the corporation. Likewise, the corporation received the sum of \$2,099.91 from Las Vegas Supply Co. for the sale of certain miscellaneous assets which was credited on the corporation books. The amount of \$1,786.16 was received from Clark and credited to him in the "Accounts Receivable—Officers" account. There is no evidence that the cash items totalling \$6,610 were deposited in the corpo-

ration's bank account as a part of the deposit of March 31, 1948, or at any other time.

Gene Clark, Inc., constructed a swimming pool at LaJolla, California, for James M. Young, Jr., and received the following checks:

Date	Amount
10/30/47	\$1,672.75
11/26/47	1,672.75
11/6/47	1,672.75
1/24/48	1,902.73

The first three checks listed above were credited to the account receivable ledger card of James M. Young. It was conceded on brief that the last check in the amount of \$1,902.73, endorsed by petitioner, was neither recorded on the books of the corporation, deposited in its bank account, nor reported as income on its tax return for fiscal 1948.

Petitioner, on behalf of Gene Clark, Inc., received the following checks for plumbing material sold by the corporation to the Valley Cities Supply Co.:

Date	Payable to	Endorsed by	Amount
9/20/47	Gene Clark	Gene Clark, Archie Koyl	\$2,731.54
6/10/48	Gene Clark	Gene Clark	1,147.00
7/21/48	Gene O. Clark	Gene O. Clark	5,000.00
8/17/48	Gene O. Clark	Gene Clark	3,000.00
11/ 8/48	Gene O. Clark	Gene Clark	2,000.00
1/24/49	Gene O. Clark	Gene Clark, Archie Koyl	1,795.55

It was stipulated that the above checks were neither entered on the books of Gene Clark, Inc., as sales, nor reported for tax purposes on either the income tax returns of the corporation or of petitioners for the years in question.

“Accounts Receivable—Officers,”

Farm Purchases

During 1946, Gene Clark took a trip to Kansas to examine some farm land, intending to purchase it for the corporation to own and operate. After locating a farm known as North Farm, in Montgomery County, Kansas, he purchased it for a total price of \$40,000, making a down payment of \$10,000 which he borrowed from the Valley Cities Supply Co. When the directors of Gene Clark, Inc., were advised that the corporation was not permitted to own such land in Kansas, they rejected the proposed purchase of North Farm. Petitioner then decided to purchase the farm land in his own name, using corporate funds as part of the consideration. As part of his financial arrangements relating thereto, petitioner, on July 31, 1946, had set up account #110 on the corporate books designated as “Notes Receivable” and an entry was made indicating a loan of \$10,000 had been extended to Clark and Koyl. Thereafter extensive withdrawals were debited to the account in 1946 in relation to the farm purchases, and will be referred to *infra*. These withdrawals were made by Clark without provision for promissory notes, security or interest. There are two credit items in 1946, which as explained by journal entry, merely reflect a transfer to another account (Outside Investment—West Covina Property). There is a debit in 1947 to Valley Cities Supply Co. which is balanced by a credit within a month. There is also a debit of \$1,591.83 dated February 28, 1947, which is unexplained. None of the

credits purport to be cash payments by Clark (or Koyl) except the \$20,000 item of April 30, 1948, in the so-called trust deeds account which was a spurious credit. The circumstances surrounding it and the use of the "Trust Deeds" as the title of the account are set forth infra in our Findings.

Originally, when it was decided that the corporation would own and operate North Farm, the board of directors had opened an account with the Citizens National Bank of Los Angeles, California, designated "Special Account No. 1," in the amount of \$5,000. However, after it was learned that the corporation could not operate the farms, on December 31, 1946, the \$5,000 deposit in said account was transferred to the "Notes Receivable—Officers" account as a debit to Clark's individual account.

Soon after the purchase of North Farm, Koyl indicated that he would like to own a farm. Petitioner thereupon bought another farm in Kansas for Koyl, known as South Farm, consisting of about 350 acres. As part of the purchase price therefor, Clark obtained approximately \$10,000 by selling plumbing materials belonging to the corporation. In addition, on August 31, 1946, a charge to the "Notes Receivable—Officers" account was made in the amount of \$11,406.80, and again on October 31, 1946, another charge of \$12,420.66 was made in connection with the purchase of the farms.

As of May 1, 1947, the "Notes Receivable" account shows debit balances of \$25,304.50 for Clark and \$10,844.79 for Koyl, totalling \$36,149.29. Said

balances were in direct proportion to their respective shareholdings in the corporation.

Some time before May 1, 1947, the designation of the "Notes Receivable — Officers" account on the general ledger was scratched out (for some unexplained reason) and changed to "Trust Deeds." A schedule denominated "Notes Receivable — Officers," attached to the corporation's return for fiscal year 1947, states, inter alia, that after it was learned that North Farm in Kansas could not be purchased by Gene Clark, Inc., the corporation extended a loan to the officers and "authorized the Officers to purchase this land in their names. The corporation received in return Trust Deeds and Signed Notes [Sic] as security until such time as the land can be profitably sold." At no time while Clark was affiliated with the corporation did it own any trust deeds, and except for the erroneous heading of the account, the corporate books do not reflect such ownership.

In 1948, petitioners purchased two other farms in Kansas for a total price of \$70,000, and for such purpose borrowed \$28,000 from the Independence Bank in Kansas on February 5, 1948, payable in five years. The loan was repaid September 26, 1950.

In March 1949, title to South Farm, owned by Koyl, was transferred to Clark.

Pursuant to the specific instructions of petitioner, the comptroller sometimes made entries in the corporate books which did not reflect the true facts or amounts involved in the particular transactions being recorded. Thus, during 1948, when Gene

Clark, Inc., declared its first and only formal dividend, petitioner received a dividend check in the amount of approximately \$20,000 (to be exact \$19,996.17). Petitioner reported the receipt of the dividend on his joint return for 1948. On April 30, 1948, after Clark received the dividend check, his "Notes Receivable—Officers" account was credited with \$20,000. Petitioner, however, did not turn back the dividend check to the corporation as a credit toward said account. Instead, Clark turned over to the corporation comptroller customers' checks, substantial in amount, totalling about \$20,000, with instructions to credit said account.

Matters Relating to Earnings and Profits Available for Distribution

The deficiencies in the instant case were predicated upon the computations contained in an exhaustive report prepared by respondent's agent during the investigation of the income tax liability of Gene Clark, Inc., for the fiscal years 1947 through 1950, inclusive, the report being admitted in evidence by stipulation of the parties to show the basis of respondent's determination. Corporate net income and tax liability were computed largely upon the bank deposit method, gross receipts being determined primarily on the basis of unreported sales and deposits in the various bank accounts of the corporation. Also, numerous deductions reported by the corporation on its returns as ordinary and necessary business expenses were disallowed.

Respondent, being unable to ascertain with exactitude the amounts of diverted funds attributable to Clark and Koyl, respectively, during the years in issue, allocated such diversions on the basis of their respective stock ownership in said corporation, 70 per cent of the unreported corporate funds being attributed as informal or constructive dividends to petitioners.

The manner in which respondent determined those amounts ultimately attributed to the officer-stockholders as informal dividends for each of the years in question was to first ascertain the earnings and profits of the corporation, as indicated above, and then to adjust this figure for so-called "unavailable" items, thus arriving at the amount "actually" available for distribution as constructive dividends.

Many items included in the revenue agent's report were admitted by counsel for petitioner to be correct at the time the report was submitted in evidence and in part are set forth in detail above in our Findings relating to unreported transactions. A number of other items connected with the unreported sales of the corporation were contested by petitioner, either at the trial or on brief.

Our Findings of Fact with respect to those items relating to earnings available for distribution which are in dispute (except for items disposed of in our Opinion, *infra*, because of failure of petitioner to sustain the burden of proof and items already fully covered in our Findings) are as follows:

(1) Corporate earnings per return

The net income per return of the corporation, as set forth hereinbefore, is properly includible in computing earnings available for distribution as dividends for each of the taxable years in controversy.

(2) Substitutions

As aforementioned, during the years 1946 through 1949, inclusive, substantial amounts of receipts from sales were neither recorded on the books of Gene Clark, Inc., nor reported in its income tax returns. In some instances, no part of the particular sales was recorded or reported. In others, less than the full amount was recorded or reported. One device used was referred to in the testimony as "substituted" sales. The device operated substantially as follows: Cash sales would be made and recorded on the books. Other sales totalling a like amount would be made, for which checks were received in payment, which were not recorded on the books. The proceeds of the latter sales, though not recorded, would be deposited, but the recorded cash sales would not be deposited. As a result, the deposit would equal the recorded sales, but an equal amount of sales would be unrecorded and unreported.

Petitioner also cashed checks as an accommodation for neighborhood stores and workmen in relatively small sums ranging up to \$100, and an undisclosed number of such checks were deposited in the various corporate bank accounts.

Apart from such "accommodation" checks, the

aforementioned checks, representing unreported sales, were "substituted" for the "cash receipts" and deposited in corporate bank accounts, and are includible in corporate gross income. We have reduced the amount of the substituted items on the basis discussed *infra* in our Opinion. The amounts reflected in the revenue agent's report, and the amounts as adjusted by us are as follows:

Fiscal Year	Amount per Report	Amount as Adjusted
1947	\$14,806.77	\$13,326.10
1948	35,419.36	30,892.36
1949	8,074.79	7,267.31

(3) Creed credit allowance

As noted above, between December, 1945 and March, 1946, petitioner performed plumbing work for Y. L. Creed, a general contractor, on several houses. Creed paid a total of \$2,922.50 therefor, of which the first payment was paid to the Plumbing Co., in the sum of \$544 on February 5, 1946. The balance of \$2,378.50 was credited to petitioner by Creed in June of 1946, at which time Clark purchased a house from him for a total consideration of \$8,500. The balance or credit of \$2,378.50 was not reported on the books of the corporation, or on the income tax returns of either the corporation or petitioners for any of the years in question. There is no evidence that Koyl received any benefit from this credit. In reconstructing corporate income for fiscal 1947, the revenue agent included as an unreported balance due from Creed the amount of \$3,058.50. The amount of \$3,058.50 was not income of the corporation, and we have eliminated it from corporate income. The credit

of \$2,378.50 was income to Clark and his wife on the community property basis and one-half of that amount is attributable to Clark for 1946.

(4) Truman Johnson credit allowance

During 1946 Gene Clark, Inc., purchased a house from Truman Johnson, a customer of the corporation, for a total price of \$22,000, and received a credit allowance of \$6,000 on the purchase price. The \$6,000 credit was not recorded on the books of Gene Clark, Inc., or reported on the corporate income tax returns for any year involved herein. See Findings of Fact, *supra*.

(5) "Notes Receivable—Officers"

As aforementioned, during the entire period in question the two officer-stockholders of the corporation maintained individual open accounts on the corporate books in the "Notes Receivable—Officers" account, to which extensive withdrawals were charged and partial repayments were credited. See Findings of Fact, *supra*.

The net withdrawals in the amount of \$36,149.29 from Gene Clark, Inc., as of May 1, 1947, constituted, in reality, disguised dividend distributions rather than loans to the officers during the taxable years involved herein.

(6) Income—deferred sales

During each of the taxable years in question the corporation entered into contracts with building contractors for the installation of plumbing and received a percentage of the total contract price as the work progressed. When the rough plumbing was installed, the corporation collected 80 per

cent of the total contract price from the contractors, of which 30 per cent was carried on the corporate books as deferred income until the contract was completed.

In a schedule attached to its Federal income tax return for fiscal 1947, the corporation explained the account as follows:

Deferred Income-Advance On Contract Sales:

This account is based on plumbing contracts not completed. On the installation of rough plumbing, fifty per cent of full contract price is set up as income, in as much as half of the contract terms have been completed. However, after installation of rough plumbing, eighty per cent of full contract price is collected from customer as per terms of the contract. (50% complete—80% collected). This additional thirty per cent collected from the customer at this period of the contract is carried on the books of Gene Clark Incorporated as deferred income until the contract has been completed. After the installation of finish plumbing has been completed, the remaining fifty per cent of contract price is set up as income and the remaining twenty per cent of contract price is collected from customer. This procedure of accounting has been consistently maintained by Gene Clark Incorporated in order not to overstate income in relation to cost of sales of each contract. At the installation of rough plumbing, it is established that the cost of the contract at this period, consisting mainly of labor, is on the average, fifty per cent of contract cost. Whereas, the cost of the contract on installation

of finish plumbing consists mainly of materials, also established to be on the average fifty per cent of contract cost.

The so-called deferred income for fiscal 1947 disclosed in the return, but not included in gross income, was in the amount of \$49,210.15. The revenue agent included the amount in adjustments to corporate income for fiscal 1947 but excluded it from earnings available for distribution in that year, and included it in available earnings for fiscal 1948.

(7) Pacific Pump, Inc.

During fiscal 1948, Gene Clark, Inc., received a check from Pacific Pump, Inc., (of which E. J. Weiss was president) for plumbing supplies in the amount of \$1,094.52. The check was included in corporate sales for 1948, but was improperly designated in the journal ledger as having been received from E. J. Weiss. In reconstructing corporate income for fiscal 1948, the revenue agent erroneously included the check as an unreported sale to Pacific Pump, Inc.

(8) Bad debts

On its tax return for fiscal year 1947, the corporation deducted as bad debts the sum of \$4,874.51 from its gross income. Of said amount, \$3,703.50 was disallowed in fiscal 1947 (no identifiable event establishing worthlessness having been proven by the corporation), and was included as "disallowed bad debts" in adjustments to corporate income for that year. The same sum of \$3,703.50 was then deducted by the revenue agent from total corpo-

rate net income available for distribution during fiscal 1947, on the theory that said amount was not actually available for distribution as dividends for that year. During fiscal year 1948, the corporation recovered \$3,216.90 of the above bad debt, and reported said amount on its return. In view of the disallowance of \$3,703.50 as a bad debt deduction for fiscal 1947, the amount recovered (\$3,216.90), together with bad debt deductions allowed by the revenue agent for fiscal year 1948 in the amount of \$1,569.40, (the total of the two items being \$4,786.30) were excluded from net income for fiscal 1948 as "nontaxable income and additional deductions." The amount of \$4,786.30 was then added back to corporate earnings available for distribution during fiscal year 1948.

Facts Relating to Farm Expenditures for 1946 and 1947

In July, 1946, after the corporate directors decided not to purchase North Farm, Clark purchased the farm for himself and planted some 300 acres of wheat thereon, which was expected to mature in the spring of 1947. His father, Clyde R. Clark, managed the farm for petitioners. Because of flood conditions in the area which destroyed the crop, there was no income from the farm operations in 1946 and 1947. No deductions for farm losses incident to the operations of North Farm were claimed on petitioners' individual tax returns for 1946 and 1947.

The corporation maintained a special account in

the Citizens National Bank of Los Angeles (Maywood), California, in the amount of \$5,000 (which was set up on the corporate books on December 31, 1946, as an account receivable from petitioner), and which was used by petitioner's father in Kansas to pay certain operating expenses of the North Farm owned by Clark and also the South Farm owned by Koyl.

During 1946 the following checks were drawn on Gene Clark, Inc.'s "Special Account No. 1" and signed by Clyde R. Clark:

Date	Amount	Payable to	Item
t. 17, 1946	\$274.95	J. W. Griffith	Seed wheat—North Farm
t. 17, 1946	102.15	Lewis Griffith	Seed wheat
v. 2, 1946	21.00	North End Service Station	Gas and oil
v. 9, 1946	195.57	W. A. Thompson	Seed wheat and oats— South Farm
c. 6, 1946	590.36	A. M. Eckelberry Co.	Taxes on both farms
c. 6, 1946	36.50	Clyde R. Clark	Repairing fences on South Farm

In addition to the above expenditures, between November 8, 1946, and December 13, 1946, salary checks in the total amount of \$950 were drawn on the special account payable to Clyde R. Clark.

Of the foregoing items, we find that the following were ordinary and necessary business expenses of operation of the North Farm for 1946:

Seed wheat	\$274.95
Taxes	223.24
Salary	475.00

Total—1946 \$973.19

During the calendar year 1947, Clyde R. Clark drew \$85 from the special account payable to E. Pincher for overhauling a truck. The check does not show that it was for the North Farm. Clyde R. Clark also drew \$200 as salary from the special account in 1947. On December 3, 1947, Gene paid taxes on his North Farm in the amount of \$223.24. For the calendar year 1947, the following were ordinary and necessary business expenses for the operation of North Farm: Salary \$100; taxes \$223.24.

The parties stipulated that petitioners sustained losses on their farm operations in Kansas during the taxable years 1948 and 1949 in the amounts of \$17,233.05 and \$17,060.52, respectively, and that said losses will be reflected in the Rule 50 computation.

Adjusted Basis—Partial Liquidating Dividend

In his statutory notice for 1948, respondent determined that petitioner received a partial liquidating dividend from Gene Clark, Inc., in the amount of \$65,095.94 during that year. For our reduction of this amount, see our Opinion, *infra*. In this connection, respondent determined that the adjusted basis of petitioner's 522 shares of stock in the corporation was \$52,100. The parties have stipulated that the basis of petitioner's 522 shares was \$61,214.49.

Ultimate Findings—Limitations and Fraud

With respect to calendar years 1945 through 1949, inclusive, the statutory notice was mailed to

petitioners on February 20, 1953. No agreement extending the statute of limitations on assessment or collection was entered into between the parties for the taxable years 1945, 1946, or 1947. With reference to the taxable years 1948 and 1949, the parties have stipulated that the statute of limitations is not an issue.

Each of the returns of Gene Clark for the years 1946 and 1947 was false and fraudulent with intent to evade tax within the meaning of section 276(a) of the Internal Revenue Code of 1939. A part of the deficiency of Gene Clark for each of the years 1946 and 1947 was due to fraud with intent to evade tax within the meaning of section 293(b).

Faye Clark filed her individual Federal income tax return for the calendar year 1946 on March 15, 1947, reporting thereon gross income in the amount of \$14,651.66. She filed her return for the taxable year 1947 on March 15, 1948, and reported gross income in the amount of \$9,130.51. The notice of deficiency for the years 1946 and 1947 was mailed to her on February 20, 1953. Respondent concedes that her returns for 1946 and 1947 were not false or fraudulent with intent to evade taxes.

Faye Clark omitted from gross income in her return for 1947 an amount properly includible therein which is in excess of 25 per cent of the amount of gross income stated in her 1947 return.

Opinion

I. Burden of Proof—Deficiencies.

We discuss the burden of proof as to deficien-

cies at this point to avoid repetition as we progress.

The burden of proof rests with petitioner to show error in respondent's determination of deficiencies. In *American Pipe & Steel Corporation v. Commissioner*, 243 F. 2d 125, (C.A. 9, 1957) affirming this Court's opinion at 25 T.C. 351, the Court of Appeals said, in part:

Petitioner having invoked the jurisdiction of the Tax Court, entered the hearing with the duty of establishing by at least a preponderance of the evidence that the determination made by the Commissioner was erroneous.

By stipulation of the parties, the revenue agent's report was received in evidence for the purpose of showing the basis of respondent's determination, but not as proof of the facts therein set forth. Petitioner's approach to the case is an attack on many of the adjustments made in the report. Respondent, for the most part, argues in favor of the adjustments made by the agent (reflected in the ultimate determination) but in some respects disagrees therewith on brief, as will appear from our discussion, *infra*. The issues are crystalized by the contentions of the parties centering around the report, or are otherwise apparent in the record.

Our own practical approach to a resolution of the issues presented is to consider those items of the report with respect to which one or another of the parties expressly disagrees, together with those which evolve upon a consideration of the record as a whole. The remaining items, with respect to which petitioner has failed to point to error, and has not

met his burden of proof will be reflected in our ultimate determinations, but will not be separately or specifically considered. As it is, our Opinion is protracted to unusual length because of the many issues actually in dispute, the numerous accounting details involved, and the complexity of reconciling and applying the various conclusions we have reached.

II. Understatement of Income—1946

For the year 1946, we are concerned only with the tax liability of Gene Clark, since assessment and collection for that year are barred by the statute of limitations as to Faye Clark.

The respondent, in his statutory notice of deficiency, determined that Clark had failed to report informal dividends received from Gene Clark, Inc., in the amount of \$44,227.13. His approach in making this determination was first to calculate the earnings of the corporation for the fiscal year ending April 30, 1947. He attributed 70 per cent of this amount to Clark as the owner of 70 per cent of the stock of said corporation. Petitioner's return was filed on a calendar year basis. Respondent attributed 84.259 per cent of Clark's share to calendar year 1946, (see discussion *infra*) and divided the amount thereof equally between Gene and Faye Clark, who filed separate returns for 1946 on a community property basis.

As already stated, the burden of proof of error is upon petitioner. Petitioner, however, citing *Helvering v. Taylor*, 293 U.S. 507, (1935) contends

that respondent's determination is arbitrary and excessive and therefore must fall in its entirety. In support of this view, petitioner urges that the amount of corporate earnings actually received by Clark in money or property was not established, and that the allocation to calendar 1946 of part of the net earnings of the company for fiscal 1947 available for distribution was without rational foundation.

In *Greenwood v. Commissioner*, 134 F. 2d 915 (C.A. 9, 1943) affirming this Court's decision in 46 B.T.A. 832, the Court of Appeals said (p. 919):

"Unquestionably the burden of proof is on the taxpayer to show that the Commissioner's determination is invalid" (*Helvering v. Taylor*, 1935, 293 U.S. 507, 515 * * *), which burden is sustained by a clear showing that the determination was arbitrary or erroneous.

Later (p. 922) the Court said:

Petitioner has failed to overcome the presumption of validity attaching to the determination of the Commissioner, * * *.

We think it apparent that petitioner's view is unacceptable. It is manifest from the evidence that substantial amounts of income of the corporation were unrecorded on its books and unreported for tax purposes by the corporation. Respondent had ample reason to infer that such money and property were retained for personal use by Clark or Koyl or both. The respondent had no means of ascertaining the precise amounts involved or the exact amounts withheld by Clark or Koyl because

of the very fact that no records were kept and that the transactions were purposefully concealed. It is clear from the record that Clark was the chief perpetrator of the various schemes calculated to siphon off corporate earnings and was well aware of what was going on. In the circumstances of this case, where petitioner admittedly withheld large sums of corporate earnings, it was reasonable for respondent to infer that Clark had seen to it that he retained his share in some approximate relationship to stockholdings. Obviously, petitioner's difficulty is of his own making in failing to keep records of amounts admittedly extracted from corporate funds, regardless of the asserted purpose of the withdrawals. In the absence of records, the respondent was obliged to resort to some reasonably effective technique for the determination of income, and petitioner cannot, by devising such concealment, deprive respondent of the right to use a practical method of making his determination, which he is forced to adopt because of such concealment. We believe the methods adopted by him and the results reached were not arbitrary under the circumstances. *Jack M. Chesbro*, 21 T.C. 123, 128 (1953), affirmed (C.A. 2, 1955) 225 F. 2d 674. The allocation of distributions to the calendar year 1946 will be discussed *infra*.

Counsel for petitioners also complain that no net worth computation was offered by respondent for corroboration or comparison. We rejected the identical argument of counsel under similar circumstances in *United Dressed Beef Co.*, 23 T.C. 879

(1955), on appeal (C.A. 9, Dec. 29, 1955), holding that respondent is under no obligation to make such a computation. Moreover, petitioner could have offered evidence of net worth if he believed it would show error in respondent's computation, but did not do so.

We also reject petitioner's argument that virtually all understatements of gross income derived from unreported corporate sales are offset by over-ceiling payments for scarce commodities on the black market made by him on behalf of Gene Clark, Inc., and that any profits derived from the resale of such commodities ultimately inured to the sole benefit of said corporation. We think there were some over-ceiling purchases and resales, but we do not believe that the purchases account for substantially all of the diversions, and there is nothing to suggest that the proceeds of any resales or the profits therefrom were ever turned in to the corporation or were accounted for in any of the income tax returns. Clark, of course, suggests nothing in the way of amounts. We do not believe his vague and general testimony, and there is no corroboration of his statements except the limited evidence of Files (largely based on statements made to him by Clark) that he knew that some such transactions took place. Files had no knowledge of the amounts of purchases or resales. Clark has fully demonstrated that he is unworthy of belief and it is not surprising that his testimony with respect to records he purportedly kept of alleged black market purchases was vague and unconvincing. Files did

not know of any records kept by Clark showing amounts expended for black market purchases. We are convinced that any books or records obtained by revenue agent Stutzman from petitioner during the course of the investigation of the tax liability of the corporation and its stockholders were all returned to Clark. In any event, petitioner was able to offer only one specific instance of a transaction involving black market activities. While, as already stated, we believe that some illicit purchases were made by petitioner, there is no credible evidence as to whether the full cost thereof was or was not included in computing cost of goods sold on the corporate tax returns involved. Of even greater significance is the lack of any evidence that the profits from resale of illicit purchases were ever recorded on the books of the Company or reported in its income tax returns. Clark himself admitted that profits from over-ceiling sales made through Gene Clark Plumbing as a front for the corporation were never recorded on the books of either Plumbing Company or the corporation, and were not reported in any of the income tax returns. All this being true, the record affords no basis for making a reasonable estimate of amounts expended on behalf of the corporation which would justify a deduction or elimination from income. Paul Masters, 25 T.C. 1093, 1100 (1956), affirmed 243 F. 2d 335 (C.A. 3, March 28, 1957); Jack M. Chesbro, *supra*, 129.

Petitioner claimed at the trial and in his opening brief that Plumbing Co. and Gene Clark, Inc.,

coexisted after April 23, 1946, as two separate and distinct business enterprises, and therefore not all the unreported sales in question were properly attributable to the corporation. Whether the unreported sales were, in the first instance, those of the Plumbing Co. or of the corporation is a question of fact. See *Miller-Smith Hosiery Mills*, 22 T.C. 581 (1954); *United Dressed Beef Co.*, *supra*, 886. We are satisfied that none of the unreported sales in controversy were reflected in the corporate returns, and the Plumbing Company filed no returns for this period.

It is our view that both organizations were treated as a single entity. Indeed, petitioner testified that after the corporation commenced operations, Plumbing Co. existed in reality only as a conduit to protect the former (which had the license to do business) from possible prosecution for violation of O.P.A. regulations. Petitioner, on reply brief, refers to the testimony of Clark to the effect that "all proceeds received from the sale of inventory which he believed belonged to Gene Clark Plumbing Company ended up in the hands of Gene Clark, Inc." Petitioner then concludes in said brief "the sole taxable entity was the corporation." Respondent likewise takes the position that all sales after May 1, 1946, were by or on behalf of the corporation. Thus, both parties appear to agree with our view that the enterprises were merged into a single entity, Gene Clark, Inc., and the profits are attributable to it whether recorded and reported or not. It goes without saying, however, that to

the extent such profits were diverted to Clark, they are likewise taxable income to him.

(1946-A) Computation of Understatement

We turn next to the computation of the understatement for 1946. The revenue agent's report was received in evidence by agreement of the parties for the limited purpose of explaining the basis for respondent's determination. The total adjustment to net income of Gene Clark, Inc., for fiscal 1947 as recapitulated in the agent's report was \$102,050.17. Although the agent, in his report, recognized that the net income per corporate return for fiscal 1947 (\$30,632.10) should be reflected in addition to the above amount of \$102,050.17, he failed, by some inadvertence, to add the net income per return in his recapitulation. Giving effect to net income per return, we reach a figure of \$132,682.27. From this amount, we deduct \$3,058.50 in accordance with our Findings of Fact eliminating the Creed transaction from corporate earnings. (It is to be noted, however, that the credit of \$2,378.50 in that transaction was income to Clark and his wife on the community property basis.) We next deduct \$1,480.67 for cashing of accommodation checks per discussion, *infra*. We also deduct \$48,694.38 as accrued Federal income taxes of Gene Clark, Inc., for fiscal year 1947, calculated on the basis of net income before taxes (\$128,143.10) as reconstructed by the agent after the adjustments we have made. The agent was in error in failing to accrue such taxes. *Estate of Esther M. Stein*, 25 T.C. 940 (1956). The remaining

earnings (\$79,448.72) were available for distribution on the basis of the foregoing. The agent deducted \$63,488.47 on the theory that the items which together total that figure were "not available" for distribution in fiscal 1947. We find no basis for this view. Our reasons will be set forth *infra*. The significant issue is the year in which these items are to be taken into account rather than the amounts themselves. Contra adjustments relating to this group of items for fiscal 1948 will be discussed later in connection with that year.

Respondent determined that Clark received taxable dividends of \$44,227.13 from Gene Clark, Inc., for 1946, half of which (\$22,113.57) was taxable to him on the community property basis. The explanation of the determination, based on the revenue agent's report, is that the corporation as a result of the diversions to Clark and Koyl, in effect distributed to them \$74,984.96 as ordinary dividends during fiscal 1947; that 84.259 per cent thereof (\$63,181.62) is allocable to calendar year 1946; and that \$44,227.13 (70 per cent of \$63,181.62) is attributable to Clark, who was the owner of 70 per cent of the stock.

As indicated above, respondent determined that one-half of \$44,227.13 (or \$22,113.56) is taxable to Clark on the community property basis as income for 1946, and a like amount is taxable to his wife. We will discuss *infra* the various adjustments and the objections raised by petitioner. Suffice it to say at this point that petitioner has failed to meet the burden of proving that respondent's determina-

tion was excessive and we therefore affirm his determination by adding \$22,113.56 to Clark's income for the year 1946. We recognize that the revenue agent's report is taken by the parties as the substantial basis for respondent's determination. We also recognize that the revenue agent erred, for example, in failing to accrue taxes of the company for fiscal 1947, and that there are minor adjustments to be considered *infra*. These errors were adverse to petitioner's interest. There were, however, also errors in his favor (such as the so-called "unavailable" items totalling \$63,488.47). It is clear that all such errors may be corrected and that, if the circumstances warrant it, respondent may be affirmed in a proper case for reasons other than those which he, himself, has assigned. *John I. Chipley*, 25 B.T.A. 1103, 1105-6 (1932). See also *James P. Gossett*, 22 B.T.A. 1279, 1284 (1931) affirmed 59 F. 2d 365 (C.A. 4).

Since the available earnings for fiscal 1947 which we have calculated above (\$79,448.72) exceed the amount shown in the revenue agent's report (\$74,984.96), we think we should add the following statement. Respondent has filed no claim for an additional deficiency for 1946. Even if such a claim were filed, however, we could not find an additional deficiency on the record before us. The burden of establishing such an additional deficiency would be upon the respondent. Our affirmance of the deficiency determined in his statutory notice is based in material respects upon petitioner's failure to meet his burden of proof. There is insufficient af-

firmative evidence in the record, however, to find an additional deficiency, with respect to which the burden shifts to respondent.

For like reasons, we point out that although we have calculated earnings available for distribution for fiscal 1947 in an amount in excess of respondent's determination of actual distributions for fiscal 1947, there is no basis for carrying the excess over into fiscal 1948 as earnings available for distribution in that year. Respondent has made no determination to that effect, and it is not supported by affirmative evidence.

(1946-B) Items Totalling \$63,488.47 Available
for Distribution in Fiscal 1947.

As indicated *supra*, we have eliminated the agent's deduction for fiscal 1947 of the total amount of \$63,488.47 in calculating earnings available for distribution (but allow corresponding adjustments for fiscal 1948). Five items comprise the above amount, and we consider each.

(1) Truman Johnson—\$6,000. As set forth in our Findings, Gene Clark, Inc., was credited with \$6,000 by Johnson in 1946. The item was for plumbing materials and services rendered by Gene Clark, Inc. The credit was applied to a house purchased by the company from Johnson in 1946. It was never recorded on the books of the company or reported for income tax purposes. It is clearly an income item to the company and is as much includible in available earnings as any other item of income. The availability of earnings is not depend-

ent upon the form of the asset by which they are represented. There is no requirement that the income be in cash or any particular tangible form, or that it may be distributed only in the form in which it is earned. Internal Revenue Code 115(a) and (b); Regulations 111, section 29.115-2.

(2) H. L. Brittain—\$1,860.40. Petitioner does not appear to contest inclusion of this item in the company's income for fiscal 1947. His position is that it was not "available for distribution," but offers no support for his view other than that the agent so treated it. Respondent, on brief, takes the position that this (as well as the other items in the group totalling \$63,488.47) was available for distribution. We agree with this view for the same reasons as those discussed in paragraph (1) above.

(3) So-called deferred sales income—\$49,210.15. The underlying facts relating to this item are set forth in our Findings and need not be repeated here. We think it is clear that the so-called deferred sales income of \$49,210.15 was properly included by the agent in the company's income for fiscal 1947, and should not have been deferred by the company until fiscal 1948. The amount was not only accrued, but actually collected in fiscal 1947. Petitioner does not appear to disagree with the view that the item should be treated as income for fiscal 1947. His position is rather that a corresponding reserve should be set up in fiscal 1947 and that the amount thereof be treated as not available for distribution in that year, at the same time admitting it would be available in fiscal 1948. For

the reasons stated in paragraph (1) above, we think it as available as any other income in fiscal 1947. We agree in this respect with respondent's position on brief. Petitioner further urges that the item should not be deemed available in both years. With this we agree, and a contra adjustment will be made in relation to fiscal 1948.

(4) Merchandise purchases—\$2,714.42. The agent disallowed merchandise purchases in the total amount of \$2,914.42 for lack of substantiation. Petitioner has offered no evidence of substantiation. One of the items comprising the total of \$2,914.42 was a check to Koyl in the amount of \$200. The agent, however, reduced available earnings by \$2,714.42 (not reflecting the Koyl check). We think it clear that neither the amount of \$2,714.42 nor the \$200 item were properly deducted from available earnings. No reason to the contrary is suggested. Respondent, on brief, resists the deduction from available earnings, and we agree. The effect of the disallowance is to increase net earnings, all of which were available for distribution for the reasons set forth in paragraph (1) above.

(5) Bad debts—\$3,703.50. The agent disallowed the deduction of bad debts in the amount of \$3,703.50 on the ground that worthlessness had not been established. Petitioner failed to establish worthlessness. The agent, nevertheless, reduced available earnings by the amount which he disallowed. Again respondent argues on brief that the reduction should not have been made, and again we agree. Likewise, as in paragraph (4) above, the

effect of the disallowance is to increase net earnings, all of which are available for distribution for the reasons set forth in paragraph (1) above.

(1946-C) Corporate Net Income
per Return—Fiscal 1947

In our computation of understatement for 1946, we included in corporate earnings for fiscal 1947 available for distribution as dividends the amount of the company's earnings reported on its return. (We deducted corporate income taxes, however, including taxes on income reported.)

Petitioner contends that the corporate earnings in the amount of \$30,632.10 reported on the original return of Gene Clark, Inc., for that period, should be deducted from earnings available for distribution as dividends. Referring to his "analysis" of such earnings, he argues that the net income per return was retained in the business, and hence was not distributed to anyone. To support his position, petitioner points out that the revenue agent, in his computation of income available for distribution as dividends, did not include therein the amount of net income per return. Respondent, on the other hand, insists that the corporate income per return should properly have been treated as part of earnings available for distribution, despite the revenue agent's failure to include them.

Examination of the revenue agent's report reveals that he computed the total net income (excluding "notes receivables" and "other investments") to be \$132,682.27, and that this amount

specifically included the corporate income per return for fiscal year 1947. See Joint Exhibit 3-C, Schedule 1, p. 5. For some unexplained reason, however, the agent, in setting up his schedule of distributions to stockholders, failed to use said amount as a starting point in computing the total net income available for distribution as constructive dividends. Instead he used only "net adjustments" to corporate income in the amount of \$102,050.17. Joint Exhibit 3-C. Schedule Q, p. 81.

The revenue agent obviously erred in this respect. We believe respondent's view on brief is the proper one, and we hold that the corporate earnings per income tax return must be included in available earnings. In his refutation of petitioner's attack on the correctness of the deficiency, respondent is not to be restricted to the computations or theory of the revenue agent. The agent's report was received by agreement merely to explain the basis for the ultimate statutory determination. As already pointed out, it discloses errors favorable as well as adverse to petitioner. We are not limited to the correction of errors only when it is to the advantage of petitioner for us to do so. Respondent has an equal right to our consideration. Petitioner was fully aware of the issue and no element of surprise is present. In all events, there is no doubt in our mind that we have the authority (and duty) under the circumstances of the instant

case to correct the error in question. See James P. Gossett, *supra*; John I. Chipley, *supra*.

We think there can be no doubt as indicated *supra*, that under the statute all accumulated net earnings and profits of Gene Clark, Inc., less accrued income taxes for fiscal 1947, were available for distribution as dividends and that the form of assets in which such earnings were reflected or distributed is immaterial. Internal Revenue Code 115(a) and (b); Regulations 111, section 29.115-2. Petitioner cites no authority to the contrary.

Needless to add, the fact that earnings are available for distribution does not mean they were actually distributed. The availability of earnings is material only to the question of whether actual distributions are to be treated as ordinary income or otherwise. Here, respondent has determined that distributions were made to petitioner and, as already stated, petitioner has failed to meet the burden of proving the contrary or that the amount so determined was excessive for 1946.

(1946-D) Substitutions

Petitioner would further reduce earnings available for distribution as dividends for fiscal year 1947 by the amount of so-called "substituted items in bank deposits" of the corporation in the sum of \$14,806.77. In reconstructing corporate income by the bank deposits method, the revenue agent included as additional gross receipts all checks which were not reported as sales or otherwise accounted

for on the books of the corporation. Upon examination of the original bank deposit slips, he discovered certain checks listed thereon, which were deposited but which did not correspond in amounts with the items in the "cash receipts" records of the corporation, and therefore, concluded that such checks constituted substitutions for cash items purportedly deposited, but actually diverted by the officer-stockholders. The underlying facts are set forth in our Findings.

The revenue agent concluded that the corporation had additional unreported sales during fiscal 1947 in the amount of \$83,960.08, of which \$14,806.77 represented such substitutions, and that the corporation failed to report on its return said sum for 1947. The amount of \$14,806.77 was therefore added to adjustments to net income for that year. The testimony of the comptroller with respect to the handling of checks and cash receipts, while general in nature and not directed to particular items, supports respondent's position. Files testified that at various times during the period in question Clark gave him checks made out to the corporation by customers for sales, which were unreported on the corporate books, in exchange for amounts of cash taken by petitioner which had been reflected on the books but had not been deposited. The checks were thereafter deposited in the corporation's bank accounts. Petitioner does not deny that substitutions occurred, but claims that any cash taken by him in connection with unrecorded sales was used by him for over-ceiling purchases. He

produced no records to support such use or the amounts which he expended for such purchases, and admits that he did not record or report the resale of any such purchases or the profits therefrom.

It is clear, also, that since the cash receipts from sales per books and sales reported in the company's income tax return reconciled in total amounts, and both reconciled in total amount with actual deposits, the unrecorded checks must have been substituted in the deposits for other items of cash which were recorded on the books but were not deposited.

Petitioner has failed to meet the burden of proving error in respondent's determination in this respect (as explained on the basis of the revenue agent's report), except to the extent set forth below.

Petitioner claims that some of the funds for which substitutions were made were used to cash checks for the accommodation of customers and employees. The testimony of Files supports the fact that accommodation checks were cashed, and the revenue agent's report shows the deposit of a number of small checks ranging up to \$100. The record does not disclose the amount of such accommodation checks. Nevertheless, where, as here, there appears to be a right to an allowance, but the amount is not shown, we are warranted in allowing what we think is an appropriate amount, resolving all doubts against the petitioner who is responsible for any inadequacies of proof. Cohan

vs. Commissioner, (C.A. 2, 1930) 39 F. 2d 540. We hold, therefore, that \$1,480.67, which is 10 per cent of the amount considered to be "substituted" checks in fiscal 1947 represented "accommodation" checks and as indicated in our "(1946-A) Computation of Understatement," supra, we have made an appropriate adjustment in determining corporate earned surplus.

(1946-E) Y. L. Creed

Petitioner urges that the revenue agent, in reconstructing corporate income for fiscal 1947 improperly included unreported sales to Creed in the amount of \$3,058.50 when the balance due Gene Clark, Inc., was only \$2,378.50. The underlying facts relating to this disputed item are set forth fully in our Findings of Fact. On the basis of our Findings, it is clear that \$3,058.50 is to be eliminated from corporate earnings for fiscal 1947. We have already made this allowance in our Opinion under the heading "(1946-A) Computation of Understatement." It is equally clear from our Findings, however, that the credit allowed Clark by Creed in 1946 in the amount of \$2,378.50 was income to Clark and his wife for 1946, one-half thereof being attributable to Clark individually.

(1946-F) "Notes Receivable—Officers"

Account—\$36,149.29

A further difference between the parties relates to the inclusion of the "Notes Receivable" account

in the amount of \$36,149.29 in the dividends distributed to Clark and Koyl for fiscal 1947. Petitioner contends that the withdrawals debited to said account in the above amount represented a series of "loans" to the two officer-stockholders and, therefore, were not properly treated as dividends distributed to them. Respondent, on the other hand, maintains that the withdrawals represented diversions of corporate funds to Clark and Koyl, and were in fact informal or constructive dividends to them.

The issue is one of fact and the intention of the parties is controlling. Carl L. White, 17 T.C. 1562, 1568 (1952). Many criteria have been used by the courts as aids in determining the intention of the parties. No one factor is alone conclusive. We must look to substance rather than to form. Neither the language nor the formalities followed preclude us from determining the true nature of the transaction. William C. Baird, 25 T.C. 387 (1955), and cases cited therein. The absence of any promissory notes (although the account was headed "Notes Receivable") or security, and the failure to charge or pay interest, while not conclusive against petitioner on the basic issue, are factors to be considered. On the other hand, the treatment of the withdrawals on the corporate books as "Notes Receivable" and the references thereto in the corporate minutes and tax returns are likewise to be considered but are not controlling, since it is established that book entries or records may not be used to

conceal realities as a means of relieving the taxpayer from liability for income taxes. Ben R. Meyer, 45 B.T.A. 228, (1946); and cases cited therein. The statement attached to the company's return for fiscal 1947 relating to "Notes Receivable—Officers" is not only obviously self-serving, but is clearly inaccurate in material respects. (See particularly the reference to trust deeds, which Clark admits were never executed.)

The following additional facts are, we think, of significance. The withdrawals of Clark and Koyl recorded in "Notes Receivable—Officers" (later "Trust Deeds") account were, on February 28, 1947, in exact proportion to their stock interests and consistent with their agreement to share in corporate earnings and profits. William C. Baird, *supra*. The funds of the company so withdrawn were primarily used as part of the purchase price of two Kansas farms, one for Clark, and the other for Koyl. It is important to note that the first purchase (North Farm) was for Clark, and that thereupon Koyl "indicated that he would like to own a farm." The second tract (South Farm) was then bought in Koyl's name. The company funds made available therefor debited to Clark and Koyl in proportion to their stockholdings, were, we think, evidently used by them in an evening-up arrangement for their own benefit and in proportion to their interests.

Upon consideration of all of the evidence material to this issue, we are convinced that the with-

drawals in issue during fiscal 1947 in the amount of \$36,149.23 were not intended to be loans, but were, in reality, diversions of corporate funds by the officer-stockholders, taxable as dividends to them. *Estate of Helene Simmons*, 26 T.C. 409 (1956). As already determined, *supra*, there were sufficient earnings available for distribution to cover the foregoing amount. Of that amount, \$25,-304.50 is attributable to Clark, and is part of the dividends determined by respondent to have been distributed to him for fiscal 1947. The computation relating thereto is included in our discussion *supra* under the heading "(1946-A) Computation of Understatement."

Petitioner further contends that the agent added the notes receivable item of \$36,149.29 in computing the net income of Gene Clark, Inc., for fiscal 1947, and urges error in this respect. While the agent's report is complicated, and in some respects confusing, we do not understand from it that he intended to increase net income by that amount. Whether he did or not, we, in our own calculation of net income as well as earnings available for distribution, did not include the item of \$36,149.29, so that we have given effect to petitioner's contention. See "(1946-A) Computation of Understatement," *supra*.

(1946-G) Other Investments—\$273.97

Petitioner contends that this item was likewise added by the agent to net income of Gene Clark,

Inc., for fiscal 1947. We do not think the agent intended to do so, but again, whether he did or not, we did not include the item in our own calculation of net income or earnings available for distribution. See "(1946-A) Computation of Understatement," *supra*.

(1946-H) Allocation of Constructive
Dividends to 1946

Petitioner contends that respondent was arbitrary in allocating constructive dividends of \$63,181.62 to Clark and Koyl for 1946 out of total constructive dividends of Gene Clark, Inc., for fiscal 1947 in the amount of \$74,984.96. The ratio allocated to 1946 was 84.259 per cent. Eight months of the company's fiscal year was in 1946 and four months in 1947. (While petitioner does not admit any constructive dividends for the period, he does not dispute, assuming there were such dividends, an allocation of 70 per cent to Clark and 30 per cent to Koyl according to their proportionate stock interests.) Clark's share for 1946 was determined to be \$44,227.13.

Petitioner has failed to establish that his share for 1946 was actually less (or greater) than the amount determined. He merely points to the fact that only two-thirds of the company's fiscal year was in 1946.

We find no basis for holding that the allocation was arbitrary. We do not know the rationale on which it was based, and there is no occasion for us

to speculate on it. Petitioner made no motion to require respondent "to file a further and better statement" (Tax Court, Rules of Practice, Rule 17(c)(1)), as a basis for challenging the allocation. No authorities are cited or reasons offered by petitioner to support his theory that the allocation, to be rational, must in this case be proportionate to the number of months of the corporation's fiscal year which fall in the taxpayer's calendar year. While, as above stated, we have no reason to speculate concerning respondent's reasons, we point out, if only for suggestive consideration, that the withdrawals from "Notes Receivable—Officers" (which we have held to be dividends) reached the substantial net amount of \$34,557.46 as of December 31, 1946, and increased only \$1,591.83 between that date and April 30, 1947, the end of the company's fiscal year. In all events, although, as stated, the burden is on petitioner, the record offers some affirmative support for respondent's action in weighing the particular allocation by attributing the larger percentage to 1946. We think petitioner has failed to prove that the allocation was erroneous or arbitrary, and there is no basis for holding it invalid. *Greenwood v. Commissioner*, *supra*.

(1946-I) Farm Losses

While our Findings of Fact are dispositive of this issue, some explanation of our views appears in order.

Clark and Koyl each bought a farm. Clark's

was known as the North Farm, and Koyl's as the South Farm. The expenditures in issue were all by checks, signed by Clark's father, and charged to a special account. Obviously, only those attributable to North Farm could be deductible. The evidence supports the conclusion that Clark's father at least managed the North Farm, but since some of the expenditures handled by him were for each farm, it is inferable that he also managed, or participated in the management of the South Farm. The evidence does not establish otherwise. The evidence likewise fails to establish that the salary paid to him (drawn on the special account by him) was solely attributable to his management of the North Farm. The basic bank deposit in the special account was \$5,000 which was made from corporate funds, but was debited to "Note Receivable—Officers."

With this background, we have allowed or disallowed farm expenditures for 1946 as follows:

We allow the deduction of the check dated October 17, 1946, for \$274.95 on which the notation appears "Seed wheat—North Farm."

We disallow check of the same date for \$102.15 because there is no evidence that it was expended for North Farm.

The check of December 6, 1946, in the amount of \$590.36 was for taxes on both farms. We allow a deduction of \$223.24 which was the amount of taxes paid on North Farm for the following year. While

the tax for 1946 may have varied slightly either way, we do not think the variation could be sufficient to require a different approach.

We disallow the check dated December 6, 1946, for \$36.50 because the check itself shows that the expenditure was for South Farm.

We disallow the check dated November 2, 1946, for \$21 because there is no evidence that it was expended for North Farm.

The check dated November 9, 1946, for \$195.57 is disallowed because it appears from the check that the expenditure was for South Farm.

We allow \$475 for salary to Clark's father, which is one-half of the total salary drawn by him for 1946. There is no evidence that the total salary of \$950 was exclusively for services in managing North Farm, or that more than half of that amount was for such services. We feel justified in allowing \$475, as above set forth because the evidence, though vague, indicates that at least half of his attention was directed to management of North Farm. See *Cohan v. Commissioner*, *supra*. One-half of the farm allowances are attributable to Gene, and one-half to Faye on the community property basis.

III. Understatement of Income—1947
(1947-A) Adjustment of Long-Term
Capital Gain

For the calendar year 1947, respondent, in his

statutory notice of deficiency, determined that Gene Clark realized a long-term capital gain of \$105.15 from the sale of a residence in lieu of \$304.75 reported on his return, and accordingly decreased the gain thereon, one-half of which was attributed to each petitioner as separate income. Petitioners claim no further adjustment with respect to this item.

(1947-B) Constructive Dividends From Gene Clark, Inc., Fiscal Year 1947.

In accordance with our discussion of the year 1946, under the heading "(1946-A), Computation of Understatement," it is apparent without repeating our analysis that Clark's share of constructive dividends from Gene Clark, Inc., for fiscal year 1947, attributable to Clark and his wife on the community property basis, is \$8,262.34. This is 70 per cent of the difference between the total dividends of \$74,984.96 attributable to both Clark and Koyl from fiscal 1947 less \$63,181.46, attributed to calendar year 1946 as dividends to them for that year. One-half of \$8,262.34 is taxable income to Clark for 1947, and a like amount is taxable income to his wife.

(1947-C) Revenue Agent's Adjustments relating to Gene Clark, Inc., Fiscal 1948

Following immediately is Schedule A, which summarizes the adjustments made by the revenue agent in relation to Gene Clark, Inc., for its fiscal year

ending April 30, 1948. The parties have agreed that the revenue agent's report be received in evidence for the purpose of showing the basis for respondent's ultimate determination. We will consider, under succeeding headings the various issues specifically disputed, including those relating to the adjustments actually made, and those affecting net income or earnings available for distribution which are not referred to by the revenue agent.

Schedule A

Summary of Revenue Agent's Adjustments Relating to Gene Clark, Inc.,

Fiscal Year Ended April 30, 1948

	Gene Clark		Archie Koyl	
	1947	1948	1947	1948
	Total			
Adjustment to Net Income	\$ 92,208.62			
Reversal FYE April 30, 1947—deferred income	49,210.15			
Assets distributed per alleged sale	3,409.91			
Recovery of Bad Debts	4,786.30			
Truman Johnson item	6,000.00			
Total	<u>\$155,614.98</u>			
Adjustments to Net Income not available	6,381.15			
Total distribution per RAR	<u>\$149,233.83</u>			
	\$43,376.22	\$62,958.37	\$18,589.81	\$24,309.43

Amount charged against surplus in Exhibit I of this report:		
Gene Clark—1947	\$ 41,238.65	
Archie Koyl—1947	17,673.70	
Partial liquidating dividends:		
Gene Clark—1947	\$43,376.22	
Less: Amount charged against surplus	41,238.65	
	<hr/>	
Gene Clark—1948	\$ 2,137.57	
	62,958.37	
	<hr/>	
Archie Koyl—1947	\$18,589.81	
Less: Amount charged against surplus	17,673.70	
	<hr/>	
Archie Koyl—1948	\$ 916.11	
	\$24,309.43	
	<hr/>	
Total distribution per RAR	\$149,233.83	
	<hr/>	
Amount carried to Schedule 5 in concurrent RAR on Gene O. Clark:		
Amount carried forward from		
FYE 4/30/1947	\$ 8,262.34	
Amount charged against surplus		
FYE 4/30/1948	41,238.65	
	<hr/>	
Total	\$ 49,500.99	
	<hr/>	

amount carried to Schedule 1A in concurrent RAR
on Gene O. and Faye Clark

amount carried to Schedule 1A in concurrent RAR
on Archie M. and Fawn A. Koyl

(1947-D) Corporate Net Income per Return,
Fiscal 1948

The revenue agent recognized that net income per return for fiscal year 1948 in the amount of \$16,726.40 should be reflected in addition to the increases set up in his adjustments (\$92,208.62) but again failed to include the income per return in his recapitulation. For the same reasons as those set forth under the heading "(1946-C) Corporate Net Income per Return—Fiscal 1947", we hold that corporate net income per return for fiscal 1948 must be given effect in determining total net income of Gene Clark, Inc., for the fiscal year in question.

(1947-E) Increased Sales

Included in the agent's adjustments to income were increased sales in the net amount of \$81,995.71. The gross increase was \$131,205.86 which the agent reduced to \$81,995.71 by properly allowing a contra deduction of \$49,210.15 which was included in the company's net income for fiscal 1947.

While petitioner does not concede any of the items, he raises specific objections only with respect to those discussed in the following subparagraphs.

(1) Substitutions. The first group of items, totaling \$35,419.36 are referred to as "substituted items," and are of the same nature, and determined in the same manner, as those discussed *supra* under the heading "(1946-D) Substitutions." The burden of proof is on petitioner to show error in respondent's determination, which is explained by the revenue agent's report, received in evidence by stipula-

tion of the parties. Moreover, as already appears in our Findings, and as analyzed in our discussion under 1946-D, *supra*, there is affirmative testimony (although much of it is general in nature) as well as circumstantial evidence, which in many respects supports respondent's determination. Except as indicated below, petitioner has not offered any acceptable evidence to the contrary, and does not deny that substitutions were made. His claim that he used any cash from unrecorded sales to make over-ceiling purchases again is not substantiated in fact (except to the limited extent of Files' testimony already referred to under the heading "Understatement of Income—1946'") or in amount. Again he did not account for any proceeds or profits from over-ceiling resale of any such purchases. Since petitioner has failed to show error, except as indicated below, we hold for respondent on this group of items, subject to the adjustments we make below, for the same reasons as those advanced under 1946-D, *supra*, which we have no occasion to repeat here.

We now discuss the particular substituted items to which petitioner specifically objects.

(a) We eliminate the item of \$1,094.52 relating to Pacific Pumps, Inc., which, as shown by our Findings in subparagraph (7) under the heading "Matters Relating to Earnings and Profits Available for Distribution," was a duplication by the agent due to an incorrect designation in the journal ledger as having been received from E. J. Weiss, who was president of Pacific Pumps, Inc.

(b) We agree with the agent's treatment of three checks from Hamilton Homes, Inc., in the respective amounts of \$1,221, \$2,295, and \$2,170. As set forth in our Findings these checks were received by the company for plumbing material and services. They were not included in the sales of the company. The first two checks were deposited in the company's bank account on September 16, 1947, as part of a total deposit of \$21,180.51. The third check was deposited in the company's account as part of a deposit in the amount of \$10,016.46. In the light of all of the evidence in the record as to substitutions, and particularly in view of the fact that the cash receipts from sales per books and sales reported in the company's tax return reconciled in total amounts, and both reconciled in total amounts with actual deposits, the only possible inference is that the Hamilton Homes, Inc., checks, which were deposited but not included in sales, were substituted for other receipts included in sales but not deposited. Petitioner has failed to meet the burden of proving otherwise.

(c) For the same reasons assigned in subparagraph (b), above, we agree with the agent's treatment of check of \$1,000 received from H. K. Niles. This check was not included in sales, but was included in the bank deposit of September 16, 1947, the total deposit being \$21,180.51.

(d) With alike factual background, and for the same reasons, we agree with the agent's treatment of a check in the amount of \$6,670 received from Southern California Investment Company. The

check was endorsed "Gene Clark, Inc., Gene Clark" and was cashed on March 19, 1948. A cashier's check in the same amount was acquired on the same date and was deposited in the company's bank account on March 31, 1948, as part of an over-all deposit of \$12,816.85. The receipt of the \$6,670 was not recorded in sales. Our Findings cover additional attending circumstances showing the receipt of \$6,610 from four different transactions which were recorded on the books of the company, but there is no evidence that the receipts totalling \$6,610 were deposited in the company's bank account.

(e) On the basis of our discussion in subparagraphs (a) to (d) inclusive, the only adjustment we have made is to reduce substituted items by \$1,094.52, as set forth in (a) above, giving a net amount of substitutions to this point of \$34,324.84. From this we again deduct 10 per cent (\$3,432.48) to allow for cashing of accommodation checks, resulting in a final net addition to income for substituted items in the amount of \$30,892.36. Petitioner has made no specific objections to the items included in substitutions other than those discussed above, and has not met his burden of proof with respect thereto.

(2) Other items—increased sales. With respect to items of increased sales, other than those discussed under substitutions (subparagraph 1, above), petitioner makes concessions as to the following: He admits on brief that \$38,009.74 was received from George Meissenburg (Valley Boulevard Plumbing

and Electric Company), and that said amount was not reported on the tax return of Gene Clark, Inc., or on the return of Clark, and that the partnership filed no return. He likewise admits on brief that a check dated January 24, 1948, in the amount of \$1,902.73 "was not reported as taxable income by the corporation (as it should have been); it was not reported in the corporation's bank account nor was it recorded on the corporation's books." He has also stipulated that the items relating to Allen T. Mitchell & Sons (\$2,294.50), A. & F. Plumbing and Heating Co. (\$1,158.44) and Ben Lang (\$1,558.44) were not entered on the company's books or reported for income tax purposes by the company or by petitioner.

As to all other items which the agent included in increased sales, while petitioner makes no express concessions, he likewise establishes no error, and we have found none.

(3) Summary—increased sales. On the basis of the discussion under subparagraphs (1) and (2) above, we reduce the computation of increased sales from the net amount \$81,995.71 to \$77,468.71.

(1947-F) Adjusted Net Income, Gene Clark,
Inc., Fiscal 1948

Petitioner establishes no error with respect to adjustments to the company's net income for fiscal 1948, other than factors considered supra, and our examination thereof likewise discloses no errors except those adjusted by us above. The agent's total net adjustments to net income of the company was

\$92,208.62. Our adjustments to increased sales, *supra*, reduce this amount by \$4,527, resulting in net adjustments, as revised, (and before adding corporate net income per return) in the amount of \$87,681.62. To this, for the reasons stated above, we add corporate net income per return in the amount of \$16,726.40, resulting in a final net income figure for the company for fiscal 1948 of \$104,408.02.

(1947-G) Earnings Available for Distribution as Ordinary Dividends, Gene Clark, Inc., Fiscal 1948.

In addition to adjustments to net income, the agent adds a number of items in computing earnings available for distribution. We consider them in the following subparagraphs.

(1) Deferred income. The agent treats the amount of \$49,210.15 as available for fiscal 1948. The item itself was included as income in fiscal 1947, and we agreed that it was properly so includible. The agent, however, treated it as unavailable for distribution in fiscal 1947. We held that he was in error in this respect, and found that it was available for distribution in that year. (See 1946-B (3), *supra*.) Consistent with our holding, we eliminate it from earnings available in fiscal 1948.

On the other hand, the agent eliminated from available earnings for fiscal 1948 the amount of \$6,381.15, which was the total of the Ben Lang item of \$1,300.75 and advance on contract sales in the amount of \$5,080.40. We think the agent likewise erred in eliminating these items. The Ben

Lang item was included in sales for fiscal 1948 (the agent transferring it from fiscal 1949) and the advance on contract sales was the same type of deferred income as the item of \$49,210.15. We think both are includible in available earnings for fiscal 1948 for the same reasons as those discussed supra under 1946-B(1) and (3). Contra adjustments will, of course, be considered for fiscal 1949.

(2) Assets distributed per alleged sale. The agent treats an amount of \$3,409.91, labeled "Assets distributed per alleged sale" as an addition to available earnings. Petitioner objects, and on the record before us, we must agree with petitioner. The agent's explanation is as follows:

Sale of depreciable business assets claimed per return as losses from said sales have been disallowed in the amount of said losses in Exhibit G of this report. The sales were not made to the third parties whose names appeared in the books of the taxpayer, but were distributed in kind to an officer or officers of the taxpayer.

Assuming, arguendo, that the statement of the agent is supported by affirmative evidence, we do not think it supports an addition to available earnings as such. The proper treatment would be to restore the disallowed losses in determining net income. We cannot tell from the agent's report whether he had done so or not, although there is some indication from an item in his adjustments, similar in amount, but not identical, that he has. If he has, the addition of \$3,409.91 to available earnings would be a duplication. If he has not, we

can only say that there is nothing in his report which would warrant us in holding that the respondent has actually determined that net income is to be increased by this item. We may add that respondent has not clarified the issue on brief.

(3) Recovery of bad debts. The revenue agent increased available earnings by the amount of \$4,786.30. Of this amount, \$3,216.90 resulted from the collection of part of the sum of \$3,703.50 which was disallowed as a deduction for fiscal 1947 (see 1946-B(5) *supra*) and was used to increase net income and available earnings for fiscal 1947. It must, therefore, be eliminated from the calculations for fiscal 1948 to avoid duplication. The balance of \$1,569.40 represents allowances of bad debt deductions of \$1,266.40 (H. L. Brittain) and "Bad debt allowance — other accounts reversed in previous year" (\$303). We find no basis for holding that the \$1,569.40 is to be used to increase available earnings for fiscal 1948.

We accordingly eliminate the entire amount of \$4,786.30 from the agent's adjustments to available earnings.

(4) Truman Johnson—\$6,000. We included this item as part of net income and available earnings for fiscal 1947. (See 1946-B(1), *supra*.) It must, therefore, be eliminated from the calculations for fiscal 1948, to avoid duplication.

(5) Accrued taxes and additions to tax. In determining earnings of Gene Clark, Inc., available for distribution as ordinary dividends for fiscal 1948, the agent failed to accrue Federal income

taxes for fiscal 1948 or additions to tax under section 293(b) for fiscal 1947. Each of these items should have been accrued. Estate of Esther M. Stein, *supra*. The respective amounts thereof are \$39,399.42 and \$19,979.69.

(6) Summary — earnings available for distribution—fiscal 1948. The total net income of Gene Clark, Inc., as finally adjusted, for fiscal 1948 was \$104,408.02. (See 1947-F, *supra*.) From this we deduct the total accruals set forth in subparagraph (5) above, in the amount of \$59,379.11, leaving a balance of earnings available for distribution as ordinary dividends in the amount of \$45,028.91.

(1947-H) Distributions, Gene Clark, Inc.,
Fiscal 1948

The revenue agent's report sets up a total distribution for fiscal 1948 of \$149,233.83. It is clear that in doing so, he included and reflected the total amount of \$63,406.36 which we have eliminated in 1947-G(1), (2), (3) and (4), *supra*. We must, therefore, deduct the latter amount, leaving net distributions of \$85,827.47. We realize, of course, that he did not include in his calculation corporate earnings per return, and that he eliminated the item of \$6,381.15 referred to by us in 1947-G(1), *supra*. While it was appropriate for us to reflect these items in determining earnings available for distribution as ordinary dividends, we cannot use them to increase actual distributions as reflected in respondent's final determination. On the other hand, while we deducted accrued taxes for fiscal

1948 and additions to tax under 293(b) for fiscal 1947 in determining earnings available for distribution as ordinary dividends, we do not reduce actual distributions by the amount of taxes and additions to tax because actual distributions may, and often do, exceed available earnings, the excess being in the nature of liquidating dividends.

Other than the adjustments we have made above, petitioner has failed to meet the burden of proving error in respondent's determination. Accordingly, we accept the figure of \$85,827.47 as representing total distributions. We apply this first to the amount of \$45,028.91, earnings available for distribution as ordinary dividends. The balance of \$40,798.56 will be treated as a liquidating dividend, (*Drybrough v. Commissioner*, 238 F. 2d 735, (C.A. 6, 1956), affirming in part and reversing on another issue *United Mercantile Agencies, Inc.*, 23 T.C. 1105) but since the part thereof allocable to Clark, (being 70 per cent thereof — \$28,558.99) does not equal the basis of his stock, it is not material as to his or his wife's taxes for 1947. It will be discussed *infra* in connection with calendar years 1948 and 1949.

Of the amount of \$45,028.91 (available earnings), we attribute 70 per cent (\$31,520.24) to Clark. Our reasons for so doing are apparent from our prior discussion, which need not be repeated here, especially since the agent uses this ratio and petitioner's testimony shows that he received a minimum of 70 per cent of whatever earnings were distributed.

The actual distributions calculated above (\$85,-

827.47) must first be applied to the earnings available for distribution as ordinary dividends in the amount of \$45,028.91, of which \$31,520.24 is attributable to Clark. On any appropriate basis of allocation of distributions (\$85,827.47) from fiscal 1948 to calendar 1947 (which included eight months of fiscal 1948), the distributions attributable to calendar 1947 would be at least sufficient to encompass total ordinary dividends including the \$31,520.24 attributable to Clark. We accordingly attribute the entire amount of ordinary dividends distributed to Clark for the company's fiscal 1948 to Clark's calendar year 1947.

We have no occasion to allocate the amount of \$40,798.56 treated as liquidating dividends (or the amount of \$28,558.99 attributable therefrom to Clark) as between calendar 1947 and calendar 1948, because it is not material to calendar 1947, since the cost of Clark's stock was not exceeded thereby in 1947.

(1947-I) Ordinary Dividend Distributions to
Clark for Calendar 1947

On the basis of the discussion in paragraphs 1947-B to 1947-H, inclusive, there was distributed to Clark for calendar year 1947 (to be accounted for by him and his wife on the community property basis) ordinary (constructive) dividends totalling \$8,262.34 from Gene Clark, Inc., allocated from fiscal 1947, and like dividends of \$31,520.24 from the same company allocated from fiscal 1948. The total is less, of course, than the amount of \$49,-

500.99 determined by respondent in his statutory notice of deficiency.

(1947-J) Farm Losses

With the background of our discussion under 1946-I, *supra*, we think it apparent that our Findings are dispositive of this issue, allowing a deduction of \$100 for salary to Clyde R. Clark, and \$223.24 for 1947 taxes. As to the check for \$85 for overhauling a truck, neither the check nor the oral evidence establishes that the payment was related to the operation of the North Farm.

The items allowed are attributable one-half to Gene and the other half to Faye on the community property basis.

IV. Income—1948

(1948-A) Net Income, Gene Clark, Inc., Fiscal 1949

(1) Corporate net income per return. The income tax return of Gene Clark, Inc., for fiscal 1949 showed a loss of \$4,154.03.

(2) Adjustments to net income. The agent, in his report (received in evidence by stipulation as explanatory of respondent's ultimate determination) makes adjustments in the total amount of \$46,575.16, which he treats as income of the company for fiscal 1949. We discuss the adjustments in the following subparagraphs.

(A) Unreported sales. The agent increases sales by a net figure of \$30,836.68. In arriving at this amount, he correctly eliminated the Ben Lang item of \$1,300.75 and "Advance on Contract Sales" in

the amount of \$5,080.40, both of which items we (and the agent) included in income for fiscal 1948 (although the agent erroneously eliminated them from available earnings for fiscal 1948). See 1947-G (1), *supra*.

(i) Substituted items. \$8,074.79 of the increase in sales was attributed to substituted items in the agent's report. From this we deduct \$807.49 for cashing of accommodation checks. See discussion under 1946-D, *supra*. As to the balance of \$7,267.30, petitioner has failed to meet the burden of proving error, and we have found none. We accordingly approve inclusion of the latter amount in unreported sales.

(ii) Additional unreported sales. With respect to additional unreported sales, petitioner makes some concessions on brief. He lists a total of \$16,064.84 in checks from Valley Cities Supply Co., all within fiscal 1949. He then makes the following statement:

The foregoing checks, totalling \$16,064.84, were issued by Valley Cities Supply Company to Gene Clark for merchandise, except that check No. 659, for \$1,795.55, was issued to Gene Clark, Inc. That check was cashed and the proceeds used to purchase two cashiers checks; one to Gene Clark in the sum of \$1,034.33, and the other to Gene Clark, Inc. for \$761.22. The check for \$761.22 was deposited in the corporation's bank account and was recorded in its books. It was reported in the income tax return as gross income for the fiscal year ended April

30, 1949. The other checks were either cashed or were used to purchase cashiers checks which were not deposited in the corporation's bank account, nor reported in its income tax return.

The agent did not include the item of \$761.22 in unreported sales.

With respect to the remaining items of unreported sales, petitioner establishes no error and we have found none.

(iii) Summary—unreported sales. On the basis of the discussion in paragraphs (1) and (2) above, we reduce the unreported sales from \$30,836.68 to \$30,029.19. Petitioner has failed to meet the burden of proof of error in respondent's ultimate determination in this respect, as explained by the revenue agent's report, except to the extent of the adjustment which we have made.

(B) Disallowance of cost of goods sold. The agent disallowed a total of \$10,216.72 for which deduction had been taken on the corporate return as cost of goods sold. Two checks of \$45.99 and \$226.50 comprising part of the foregoing were disallowed as personal, family or living expenses of the officers of the corporation. The remaining check of \$9,994.23 was payable to Archie Koyl, and was disallowed as cost of goods sold for want of substantiation.

Petitioner has again failed to meet the burden of proof of error in relation to such disallowances which, as explained by the revenue agent's report, are reflected in respondent's ultimate determination.

(C) Other adjustments to net income. Petitioner does not appear to question, and has failed to meet the burden of proving error, in (1) disallowance of compensation of officers in the amount of \$2,499.91; and (2) disallowance of other expenses in the amount of \$3,021.85.

(D) Summary—net income. On the basis of our discussion in paragraphs (A), (B) and (C) above, we reduce the agent's adjustments to net income from \$46,575.16 to \$45,767.67. The agent, however, failed to reflect the loss per corporate income tax return. We, therefore, make a further reduction of \$4,154.03, as a result of which corporate net income for fiscal 1949, after our adjustments, is \$41,613.64.

(1948-B) Earnings Available for Distribution
as Ordinary Dividends for Fiscal 1949

Subject to the adjustments which we make below, the corporate net income of \$41,613.64 is available for distribution as ordinary dividends for fiscal 1949. See discussion under 1946-B(1), *supra*.

(1) Erroneous additions to and eliminations from available earnings. The agent increases available earnings by an item of \$1,300.75 relating to Ben Lang, and an item of deferred income of \$5,080.40. We have already held that these items are includible for fiscal 1948 (see 1947-G(1), *supra*) and they must be eliminated in determining available earnings for fiscal 1949.

On the other hand, the agent deducts an item of \$7,976.11, which has been included in income for

fiscal 1949 as advance on contract sales. We hold that the agent has erroneously deducted this amount in calculating available earnings for fiscal 1949 on the basis of our discussion under 1946-B (3), *supra*.

(2) Accrual of taxes and additions to tax. In determining earnings of Gene Clark, Inc., available for distribution as ordinary dividends for fiscal 1949, the agent failed to accrue Federal income taxes for fiscal 1949 or additions to tax under section 293(b) for fiscal 1948. Each of these items should have been accrued. Estate of Esther M. Stein, *supra*. The respective amounts thereof are \$14,555.23 and \$17,826.18, or total accruals of \$32,381.41.

(3) Summary — earnings available for distribution, fiscal 1949. The total net income of Gene Clark, Inc., as finally adjusted by us was \$41,613.64. (See 1948-A(2)(D), *supra*.) From this we deduct the accruals set forth in 1948-B(2) above in the amount of \$32,381.41, leaving a balance of earnings available for distribution as ordinary dividends in the amount of \$9,232.23. As will appear *infra*, in discussing actual distributions for fiscal 1949, it is apparent that on any tenable basis for allocation as between calendar years 1948 and 1949, an amount in excess of \$9,232.23 would be allocable to 1948. Distributions for fiscal 1949 must first be applied to available earnings, so that the full amount of \$9,232.23 is attributable to calendar 1948. Since Clark was the owner of 100 per cent of the stock from prior to April 30, 1948, until March

1, 1949, it likewise follows that the entire \$9,232.23 (less than the amount determined by respondent) is to be deemed distributed to him for calendar 1948. It is to be noted, however, that he included in the joint return for 1948 a dividend from Gene Clark, Inc., in excess of \$9,232.23, so that on the record before us there was no understatement of dividends on the 1948 return.

(1948-C) Distributions, Gene Clark, Inc.,
Fiscal 1949

Respondent determined that Clark received unreported dividends for fiscal 1949 in the total amount of \$26,233.75 (of which he attributed \$23,351.09 to calendar 1948 and \$2,882.66 to calendar 1949). He classified the entire amount as taxable dividends. It is clear, however, that (to the extent we find that actual distributions were made) any excess of such distributions over available earnings must be held to be liquidating dividends to be applied against the cost of Clark's stock.

It is apparent from the revenue agent's report that he eliminated the item of \$7,976.11 referred to by us in 1948-B(1), *supra*. While it was appropriate for us to reflect this item in determining earnings available for distribution as ordinary dividends, again (as in 1947-H, *supra*) we cannot use it to increase actual distributions as reflected in respondent's final determination. On the other hand, it is equally clear that the agent did include and reflect in the amounts distributed the Ben Lang item of \$1,300.75 and the deferred income item of

\$5,080.40 which we included in the prior year. (See 1948-B(1), *supra*.) We must, therefore, deduct the total of these amounts (\$6,381.15) from the amount determined (\$26,233.75) leaving a balance of \$19,852.60 as actual distributions. For the reasons stated in 1947-H, *supra*, we do not further reduce actual distributions by accrued taxes or additions to tax.

Except for the adjustments we have made, petitioner has failed to meet the burden of proving error in respondent's determination of the amount of distributions for fiscal 1949.

Of the total distributions of \$19,852.60, we have treated \$9,232.23 as ordinary dividends to Clark for calendar 1948 leaving a balance of \$10,620.37 yet to be considered. Clark, however, ceased to be a stockholder on March 1, 1949. He was owner of 100 per cent of the stock for ten months of fiscal 1949. We must, therefore, attribute to him only five-sixths of the total distributions of \$19,852.60, or \$16,543.83. The difference of \$3,308.77 must be deducted from the balance of \$10,620.37 above referred to, leaving \$7,311.60 to be treated as a liquidated dividend to Clark which will be applied against the cost of his stock. Since this amount, when added to \$28,558.99, similarly attributed for fiscal 1948 (see 1947-H) does not equal the cost of Clark's stock, there is no capital gain resulting from the liquidating dividends, which, however, will be further considered in relation to calendar 1949.

(1949-D) Farm Losses

Respondent originally disallowed farm losses of \$17,233.05 for 1948, but by stipulation, the amount thereof has been allowed.

(1948-E) No Understatement for Calendar 1948

In the light of the entire discussion of income for the calendar year 1948, we find upon the record before us no understatement of income upon the joint return of Clark and his wife for that year.

V. Income—1949

(1949-A) Farm Losses

Respondent originally disallowed farm losses of \$17,060.52 for 1949, but, by stipulation, the above amount has been allowed as a deduction. Likewise, by stipulation, it was agreed that petitioner sustained a net operating loss for 1950 in the amount of \$4,513.62, and that said amount is properly allowable as a loss carry-back to the year 1949.

(1949-B) Interest Unreported

Respondent determined unreported interest for 1949 in the amount of \$242.49. Petitioner assigns no error with respect to this item.

(1949-C) Ordinary Dividends

Respondent determined unreported ordinary dividends from Gene Clark, Inc., in the amount of \$2,882.66. On the basis of the discussion under 1948-B(3) and 1948-C, both *supra*, we hold that petitioner received no ordinary dividends from

Gene Clark, Inc., in 1949, all ordinary dividends as determined by us from the corporation for fiscal 1949 being attributed to calendar 1948.

(1949-D) Gain on Exchange of Gene Clark,
Inc., Stock

As of March 1, 1949, Clark sold or exchanged all of the stock of Gene Clark, Inc. The selling price, per return, was \$70,747.76. The agent reduced this by \$36,149.29 (representing distributions treated as dividends in prior years) and his report shows a recognized gain of \$34,598.47, on the theory that Clark had exhausted his cost in prior years.

The parties have stipulated that the cost of said stock was \$61,214.49. On the basis of our prior discussion, the only amounts by which said cost is to be reduced are liquidating dividends of \$28,558.99 (see 1947-H, *supra*) and \$7,311.60 (see 1948-C, *supra*). These amounts total \$35,870.59, leaving unrecovered cost in the amount of \$25,343.90. On the basis of the foregoing, the gain recognized was only \$9,254.57. Since the reported recognized gain from the sale of said stock exceeded \$9,254.57, there was no understatement of capital gain for 1949.

(1949-E) No Understatement for Calendar
Year 1949

On the basis of our discussion of income for the calendar year 1949, on the record before us, we find no understatement on the joint return for Clark and his wife for that year.

VI. Fraud

General

Respondent concedes that the individual returns of Faye Clark for the years 1946 and 1947 were not false and fraudulent with intent to evade taxes, and that no part of any deficiency in her taxes for either of said years was due to fraud. He contends, however, that the returns of Gene Clark for 1946 and 1947, and the joint returns for 1948 and 1949, were false and fraudulent with intent to evade taxes (section 276(a)), and that some part of each deficiency in respect thereof was due to fraud (section 293(b)).

Since we have found no deficiency with respect to the years 1948 and 1949, we limit our discussion of fraud to the individual returns of Gene O. Clark for 1946 and 1947.

Respondent has the burden of establishing fraud by clear and convincing evidence. *Arlette Coat Co.*, 14 T.C. 751 (1950). It is not incumbent upon respondent to prove that the entire deficiency was based on fraud as a basis for sustaining additions to tax under section 293(b), which requires only that "some part" of the deficiency be due to fraud.

Our conclusions as to fraud are based upon a consideration of the entire record properly before us on that issue, and we are not limited to a consideration of respondent's affirmative evidence. *Frank Imburgia*, 22 T.C. 1002 (1954); *Wallace H. Pettit*, 10 T.C. 1253 (1948); *L. Schepp Co.*, 25 B.T.A. 419 (1931).

We recognize, of course, that fraud is not to be

predicated in any respect upon petitioner's failure to meet the burden of proving error with respect to respondent's determination of deficiencies. It must be affirmatively established that each return in question was false and fraudulent with intent to evade taxes, from the standpoint of limitations, and that some part of each deficiency is due to fraud with intent to evade taxes if additions to taxes under section 293(b) are to be approved. See *Frank Imburgia, supra*.

We will, of course, discuss the issue of fraud specifically for each of the years 1946 and 1947. It should be noted here, however, that the intent to defraud is established beyond question. Because of our extensive Findings, and previous discussion of particular items, we limit ourselves in this respect to pointing out a few of the clear and significant indicia thereof.

It is clear from the record that substantial (though undetermined amounts of receipts from sales made by Gene Clark, Inc., were neither recorded on its books nor reported on its income tax returns. It is likewise established that substantial amounts thereof passed to Clark personally. Clark, who was in general control of over-all corporate operations, admits that it was his own idea not to record certain sales as a means of withholding cash from the corporation, and that he directly participated in such diversions. On a number of occasions, Clark instructed Files, the comptroller of the corporation, to set aside cash receipts from sales and to turn the proceeds over to him without recording the

sales on the books. Clark frequently gave customers' checks for sales which were unrecorded on the books, in place of cash for like amounts which had been entered on the books, bringing about the substitutions which have been discussed *supra*. The cash went directly to Clark. Clark personally sold plumbing materials from the El Monte (main) office without accounting for or recording the proceeds on the books of the company. He also engaged in over-ceiling sales without accounting for all of the proceeds or profits therefrom. The proceeds from the many transactions summarized above were not reported in the income tax returns of either Clark or Gene Clark, Inc. Clark's explanations were largely unworthy of belief. In the main, he took the position that substantial funds, which he admitted that he took, were spent for materials and supplies, including the payment of over-ceiling charges. He had no record of the amounts which he claimed to have spent in this way and admitted not only that the books did not record his activities, but that he had not accounted for the profits from such transactions. See *M. Rea Gano*, 19 B.T.A. 518, 533 (1930).

As already indicated, we think the intent to defraud is abundantly established. We add, for completeness, that we have reached our conclusions on the issue of fraudulent intent without in any way relying upon the evidence of Clark's conviction upon his plea of *nolo contendere* for tax fraud relating to Gene Clark, Inc., for the fiscal years 1948 and 1949. It is clear that the evidence is admissible

as reflecting upon Clark's credibility as a witness (Lillian Kilpatrick, 22 T.C. 446 (1954), affirmed 227 F. 2d 240 (C.A. 5)) but even in this respect, it is obvious from the record in the instant case that he is unworthy of belief without resorting to his conviction to bolster that view.

Fraud—1946

We think that the evidence of Files with respect to unrecorded and unreported sales and diversions of corporate funds by Clark (much of which Clark himself admits, but tries to avoid by untenable explanation) gives rise to the inference of fraud for the calendar 1946. While the amounts cannot be precisely calculated, it is clear that they were substantial, and that part of Clark's deficiency for calendar 1946 was attributable thereto.

Since the corporate return for fiscal 1947 itself discloses earnings available for distribution, there appears to be no doubt that the diversions during the last eight months of the calendar year 1946 represented, at least in part, constructive dividends to Clark which were not included in the separate returns filed by him and his wife on the community property basis.

We recognize that the foregoing is based to some extent upon inference from circumstantial evidence. Needless to say, circumstantial evidence, if clear and convincing, is sufficient of itself to establish fraudulent understatements, particularly where taxpayer's failure to keep proper records makes it

difficult to pin point particular items. We, nevertheless, think it helpful to discuss two specific items in 1946, the latter of which, in all events, affirmatively demonstrates the existence of fraudulent intent.

The first is the Creed item. During the period from December 1945 to March 1946, before Gene Clark, Inc., was incorporated, Clark performed substantial plumbing work for Creed, a general contractor, for which Creed agreed to pay \$2,922.50. A payment of \$544 was made by Creed which was deposited to the account of Gene Clark Plumbing Co. and recorded in the sales of that company. The balance of \$2,378.50 was credited by Creed in June, 1946, to Clark personally, on account of the purchase price of a house which Clark was buying from Creed. The credit was not reported in Clark's income tax return or in the return for Gene Clark, Inc. Gene Clark Plumbing Co. filed no return for 1946. Clark individually got the full benefit of the payment, which should have been included in the returns of himself and his wife on the community property basis. Whether the item of \$2,378.50 is treated as a dividend (as respondent treated it) or as direct income to Clark properly received by Clark, or improperly appropriated by him for his own benefit, is here unimportant, since there were corporate earnings materially in excess of that amount available for distribution as disclosed by the corporate return for fiscal 1946. Clark received the benefit in 1946 but did not report his share of the income in his return. It is obvious that some

part of the deficiency is due to the omission of this item.

If the Creed item were considered as an isolated factor, we would be unwilling to hold that the failure to report it for income tax purposes was sufficient to establish fraud, since it might have been an oversight. When considered in the light of all of Clark's manipulations, and particularly in the pattern of the Truman Johnson item, to be discussed next, we think it is of some significance as an identifiable link in the chain of events which resulted in the understatement of income. We turn then to the Johnson item.

On October 5, 1946, Gene Clark, Inc., entered into a contract with Truman Johnson, a building contractor, to supply plumbing materials and services to Johnson on ten new houses. The transaction was handled in the following manner at Clark's request. The actual price for the materials and services was \$9,300. In the written contract, however, the price was set up as \$3,300. The difference of \$6,000 was credited by Johnson to Gene Clark, Inc., as part payment on a house which the corporation purchased from Johnson in 1946. (The house was sold by the corporation to Clark in 1947.) Johnson's books recorded the full cost of the materials and services furnished, including the \$6,000. The \$6,000 was neither recorded on the books of Gene Clark, Inc., nor reported on its income tax returns.

Here Clark's intention to defraud was deliberate and obvious. While in the first instance, the fraud from the income tax standpoint affected the tax of

the corporation, it likewise had its effect upon the income and tax of Clark arising out of diversions from the corporation by Clark, which, to the extent of the actual diversions, and not to exceed available earnings, are to be treated as ordinary dividends. Whether or not Clark was familiar with all of the income tax accounting factors involved is not material. His intent was to defraud, both as to himself and the corporation, and he succeeded.

On the basis of the foregoing discussion, we hold that Clark's individual income tax return for 1946 was false and fraudulent with the obvious intent to evade taxes, and that some part of his deficiency for 1946 (we are not concerned with how much, but the amount was undoubtedly substantial) was due to such fraud with intent to evade taxes. It follows that additions to tax under section 293(b) are to be applied for that year.

Fraud—1947

What we have said generally with respect to unrecorded sales of Gene Clark, Inc., diversions of corporate funds by Clark to himself, and failure to account therefor in his income return for 1946 applies equally to 1947. Again, however, we consider specific items.

As set forth in greater detail in our Findings, Gene Clark, Inc., in 1947, received three payments from Hamilton Homes, Inc., totalling \$5,686. These payments were not recorded as sales on the books of the company. They were deposited in the bank account of the company, but such deposits merely

substituted the Hamilton Homes, Inc., payments for payments from other customers whose payments were recorded on the books but not deposited. While Clark does not concede the particular substitution, he admits that substitutions were made from time to time. The sales per books, per returns, and the bank deposits, reconciled with each other and the only possible inference or explanation is that substitutions for unrecorded sales were made as above described. That at least a substantial part of the undeposited amounts went to Clark is obvious without repeating our analysis of the evidence. Here again, it is not significant on the fraud issue to place a label on the diversions. There were ample earnings of the company available for distribution as ordinary dividends. Thus, whether we treat the diversions as ordinary dividends or direct income to Clark, the result is the same. The income was not reported by Clark or his wife.

Since we have covered the H. K. Niles check of \$1,000 in our Findings, and since the facts and inferences as to substitution is the same as discussed with respect to Hamilton Homes, Inc., we need only say that this is another specific item, a substantial part of which was income to Clark, unreported by him or his wife.

On September 20, 1947, Clark received a check from Valley Cities Supply Co. for \$2,731.54. It is stipulated that this check was not entered on the books of Gene Clark, Inc., or reported by the corporation, or by either Clark or his wife, for income tax purposes.

On the basis of the foregoing, we hold that the income tax return of Gene Clark for 1947 was false and fraudulent, with intent to evade taxes, and that part of his deficiency for 1947 was due to fraud with intent to evade taxes. Accordingly, additions to tax under section 293(b) are to be applied.

VII. Limitations

We are concerned with the issue of the statute of limitations only with respect to the separate returns of Gene and Faye Clark for the calendar years 1946 and 1947. We take up the returns of Faye Clark first. Respondent concedes that her returns for these years were not false or fraudulent with intent to evade taxes, but has not abandoned his alternative contention that the five-year period of limitations provided for in section 275(c) is applicable to the year 1947. On this issue, the respondent has the burden of proof. *Lois Seltzer*, 21 T.C. 398 (1952).

With respect to the year 1946, we note that her return was filed on March 15, 1947, and that respondent's statutory notice of deficiency was mailed to her on February 20, 1953, more than five years later. No waiver of the statute of limitations has been filed with respect to 1946. It is thus apparent that the provisions of section 275(c) of the Internal Revenue Code of 1939 are not applicable, and since there was no fraud urged with respect to the return in question, assessment and collection of taxes are barred for 1946.

For the calendar year 1947, Faye Clark's return

was filed on March 15, 1948. The statutory notice of deficiency was transmitted to her on February 20, 1953, more than three but less than five years after the return was filed. Again, there was no waiver of limitations. Since it was conceded that there was no fraud, limitations will apply under section 275(c) unless she omitted from gross income an amount properly includible therein in excess of 25 per cent of gross income stated in the return. The gross income stated in her return was \$9,130.51, of which 25 per cent is \$2,282.63.

Since the application of section 275(c) is raised by respondent in his answer, the burden of proof is on him. He need not, however, establish a precise amount as long as it is apparent from the affirmative evidence that at least \$2,282.63 (25 per cent of Faye's gross income per return) was omitted. We think respondent has clearly met the burden of proof. We need go no further on this issue than refer to the following facts.

In part VI of our Opinion, under the heading of "Fraud—1947," we discussed the Hamilton Homes, Inc., and H. K. Niles substitutions in the respective amounts of \$5,686 and \$1,000. It is obvious that none of the checks making up these items were accommodation checks. We also discussed the Valley Cities Supply Co. check of \$2,731.54 which was neither entered on the books of Gene Clark, Inc., nor reported by the corporation, Clark, or his wife. It is clear that at least 70 per cent of the total of these amounts constituted gross income diverted from the corporation by Clark, to be accounted for

by Clark and his wife on the community property basis in their separate returns for 1947. Again, for the reasons stated in discussing the fraud issue, it is not significant whether the items be deemed direct income to Clark and his wife, or constructive dividends. They represent gross income in any event, and one-half of Clark's share of each was includible, on the community property basis, in gross income on Faye's individual return for 1947. The amount so omitted from gross income on her return which should have been included therein was well in excess of \$2,282.63, and the statute of limitations, therefore, is not a bar to assessment and collection as to Faye Clark for 1947. The question of intent on the part of Faye is not material to this issue.

With respect to Gene Clark, we hold that the returns filed by him for 1946 and 1947 were false and fraudulent with intent to evade tax, and the statute of limitations does not bar assessment and collection of any deficiency for such years. (See discussion of fraud, *supra*.) It is, therefore, unnecessary to consider respondent's alternative contention that section 275(c) is applicable to the year 1947. If it were, we think it quite evident from our discussion above relating to Faye Clark, that Gene likewise omitted an amount from gross income which was in excess of 25 per cent of the amount of gross income shown on his return, and that the bar of the statute of limitations accordingly would not apply.

The parties have stipulated that the statute of

limitations is not in issue for the years 1948 and 1949, and we have found no net understatement for those years.

VIII. Jeopardy Assessments

The record discloses that there have been certain jeopardy assessments and payments with respect thereto. It is understood that such assessments and payments will be taken into account administratively and there is no occasion for us to discuss or reflect them in our Opinion.

Decisions will be entered under Rule 50.

Served and Entered July 17, 1957.

[Title of Tax Court and Docket No. 48542.]

COMPUTATION FOR ENTRY OF DECISION

The attached computation reflecting an overpayment in Federal income tax of \$361.75 and no deficiency in penalty for the taxable year 1945; a deficiency in Federal income tax and penalty in the amounts of \$11,752.35 and \$5,876.18, respectively, for the taxable year 1946; and a deficiency in Federal income tax and penalty in the amounts of \$9,141.45 and \$4,570.73, respectively, for the taxable year 1947 (without considering the jeopardy assessments for the years 1946 and 1947 made prior to the issuance of the notice of deficiency), is submitted on behalf of the respondent in compliance with the

opinion of the Court determining the issues in this case.

The computation is submitted without prejudice to the respondent's right to contest the correctness of the decision entered herein by the Court pursuant to the statute in such cases made and provided.

/s/ NELSON P. ROSE, ECC,
Chief Counsel, Internal Revenue
Service.

Of Counsel: Melvin L. Sears, Regional Counsel,
R. E. Maiden, Jr., Special Assistant to the Re-
gional Counsel, Internal Revenue Service.

Without prejudice to the right of appeal, it is agreed that the attached computation is in accordance with the opinion of the Tax Court in the above-entitled case.

/s/ THOMAS A. BAIRD,
Counsel for Petitioner.

Statement of Account

Ap:LA:AA-EWM

In re: Gene O. Clark, 304 Marguerite, Corona Del Mar, California.

Docket No. 48542

Income Tax — Year 1945

		50% Fraud	
Paid:	Tax	Penalty	Interest
March 15, 1946	\$ 141.36	None	None
Paid on joint estimated tax:			
March 15, 1945 \$	250.00		
June 15, 1945	250.00		
Sept. 15, 1945	950.00		
Jan. 15, 1946 ..	250.00		
Total	\$1,700.00		

	Tax	50% Fraud Penalty	Interest
Gene Clark's one-half ..	850.00	None	None
January 18, 1954	361.75	None	None
<hr/>			
Total paid	\$ 1,353.11	None	None
Liability	991.36	None	None
<hr/>			

Overpayment (Section 322(d)

(1)(D) of the 1939 Internal

Revenue Code) \$ 361.75 None None

Return filed March 15, 1946.

Deficiency notice dated February 20, 1953.

Claim for refund filed September 20, 1955.

Year 1946

	Tax	50% Fraud Penalty	Interest
Paid:			
March 15, 1947	\$ 1,956.75	None	None
Paid on estimated tax:			
March 15, 1946	\$199.50		
June 17, 1946	199.50		
Sept. 16, 1946 ..	199.50		
Jan. 17, 1947	199.50		
	798.00	None	None
<hr/>			
Tax withheld by employer	945.71	None	None
January 18, 1954	5,423.91	None	None
<hr/>			
Total paid	\$ 9,124.37	None	None
Liability	15,452.81	\$ 5,876.18	\$ 4,071.94
<hr/>			
Deficiency in payment	\$ 6,328.44	\$ 5,876.18	\$ 4,071.94

Year 1947

Paid:			
March 15, 1948	\$ 337.87	None	None
Tax withheld by employer	1,418.82	None	None
January 18, 1954	5,444.42	None	None
<hr/>			
Total paid	\$ 7,201.11	None	None
Liability	\$10,898.14	\$ 4,570.73	\$ 2,618.84
<hr/>			
Deficiency in payment	\$ 3,697.03	\$ 4,570.73	\$ 2,618.84

Computation Statement

Ap:LA:AA:EWM

In re: Gene O. Clark, 304 Marguerite, Corona Del Mar, California.

Docket No. 48542

Income Tax Liability

Payments on

Year		Statutory Deficiency	Jeopardy Assessments	Overpayments	
				Tax	50% Penalty
1945	Tax	None	\$ 361.75	\$ 361.75	—
	Penalty	None	None	—	None
1946	Tax	\$11,752.35	5,423.91	None	—
	Penalty	5,876.18	None	—	None
1947	Tax	9,141.45	5,444.42	None	—
	Penalty	4,570.73	None	—	None
Totals		\$31,340.71	\$11,230.08	\$ 361.75	None

Overassessment of Jeopardy Assessments

Year	Tax	Interest	50% Penalty
1945	\$ 803.89	\$ 326.76	\$ 401.95
1946	300.47	104.41	150.23
1947	2,957.26	347.19	1,478.63
Totals	\$4,061.62	\$1,278.36	\$2,030.81

The computation of tax liability shown herein is in accordance with the opinion of The Tax Court of the United States filed July 17, 1957, for decision to be entered under Rule 50.

Year 1945

It has been stipulated that there is no statutory deficiency in assessment for the year 1945 and that there is an overpayment of \$361.75. The adjustments of income and tax liability shown in the deficiency notice dated February 20, 1953, are therefore reversed.

Income tax liability	\$991.36
Income tax liability disclosed by the return, Account No. 3051314, Los Angeles District	991.36

Statutory deficiency in income tax	None
50% fraud penalty	None

	Tax	50% Fraud Penalty	Interest
Assessed:			
Liability disclosed by the original return, Account No. 3051314, Los Angeles District	\$ 991.36		
Jeopardy Spl. #5, December 24, 1952 list, Page 0, Line 0	803.89	401.95	326.76
Total assessed	\$ 1,795.25	\$ 401.95	\$ 326.76
Liability	991.36		
Overassessment	\$ 803.89	\$ 401.95	\$ 326.76

Year 1946

Adjustment to Net Income

Net income as disclosed by the deficiency notice dated February 20, 1953	36,765.23
Additional deduction:	
(a) Farm loss	486.59
Net income as revised	\$36,278.64

Explanation of Adjustment

(a) Net income is decreased \$486.59, representing allowance of deduction for farm loss. Computation of farm loss is as follows:

Income from farm	None
Deductions allowed by opinion of the Tax Court of the United States:	
Seed wheat	\$274.95
Taxes	223.24
Salary	475.00
Farm loss	\$973.19
Petitioner's community one-half	\$486.59

Computation of Tax
Year 1946

Net income	\$36,278.64
Less: Exemptions	1,500.00
<hr/>	
Income subject to tentative tax	\$34,778.64
Tentative tax	16,266.12
Less: 5%	813.31
<hr/>	
Income tax liability	\$15,452.81
Income tax liability disclosed by the return, Account No. 3039848, Los Angeles District	3,700.46
<hr/>	
Statutory deficiency in income tax	\$11,752.35
50% fraud penalty	5,876.18

	Tax	50% Fraud Penalty	Interest
Assessed:			
Liability disclosed by the original return, Account No. 3039848, Los Angeles District	\$ 3,700.46	None	None
Jeopardy Spl. #5, December 24, 1952 List, Page 0, Line 2	12,052.82	6,026.41	4,176.05
<hr/>		<hr/>	
Total assessed	\$15,753.28	\$ 6,026.41	\$ 4,176.05
Liability	15,452.81	5,876.18	4,071.94
<hr/>		<hr/>	
Overassessment (abatable)	\$ 300.47	\$ 150.24	\$ 104.11

Year 1947

Adjustments to Net Income

Net income as disclosed by the deficiency notice dated February 20, 1953	\$33,781.21
Nontaxable income and additional deduction:	
(a) Unreported dividends	\$4,859.21
(b) Farm loss	161.62
<hr/>	
Net income as revised	\$28,760.38

Explanation of Adjustments

(a) Unreported dividends as shown by the deficiency notice	\$49,500.99
Unreported dividends per the opinion of the Tax Court of the United States	39,782.58
Decrease in unreported dividends	\$ 9,718.41
Petitioner's community one-half	4,859.21
(b) Net income is decreased \$161.62, representing allowance of deduction for farm loss. Computation of farm loss is as follows: Income from farm	None
Deductions allowed by opinion of the Tax Court of the United States:	
Salary	\$100.00
Taxes	223.24 323.24
Farm loss	\$ 323.24
Petitioner's community one-half	161.62

Computation of Tax

	Year 1947	Ordinary Rates	Alternative Tax
Net income	\$28,760.38	\$28,760.38	
Less: Exemptions	1,500.00	1,500.00	
Income subject to tentative tax	\$27,260.38	\$27,260.38	
Less: Net long-term capital gain			530.71
Balance of income subject to tax	\$27,260.38	\$26,729.67	
Tentative tax	11,521.44	11,192.40	
Less: 5%	576.07	559.62	
Tax at ordinary rates (not applicable)	\$10,945.37		
Partial tax			10,632.78
Add: 50% of \$530.71, net long-term capital gain			265.36
Alternative tax (lesser tax)			\$10,898.14
Income tax liability			\$10,898.14
Income tax liability disclosed by the return, Account No. 3050798, Los Angeles District			1,756.69
Statutory deficiency in income tax			\$ 9,141.45
50% fraud penalty			4,570.73

	Tax	50% Fraud Penalty	Interest
Assessed:			
Liability disclosed by the original return, Account No. 3050798, Los Angeles District	\$ 1,756.69	None	None
Jeopardy, Spl. #5, December 24, 1952 List, Page 0, Line 4	12,098.71	\$ 6,049.36	\$ 3,466.03
Total assessed	\$13,855.40	\$ 6,049.36	\$ 3,466.03
Liability	10,898.14	4,570.73	2,618.84
Overassessment (abatable)	\$ 2,957.26	\$ 1,478.63	\$ 847.19

[Endorsed]: T.C.U.S. Filed November 13, 1957.

[Title of Tax Court and Docket No. 48543.]

COMPUTATION FOR ENTRY OF DECISION

The attached computation reflecting an overpayment in Federal income tax of \$370.80 and no deficiency in penalty for the taxable year 1945; an overpayment in Federal income tax of \$5,470.80 and no deficiency in penalty for the taxable year 1946; and a deficiency in Federal income tax in the amount of \$9,288.48 and no deficiency in penalty for the taxable year 1947 (without considering the jeopardy assessment for 1947 made prior to the issuance of the notice of deficiency or payments made pursuant to said jeopardy assessment), is submitted on behalf of the respondent in compliance with the opinion of the Court determining the issues in this case.

The computation is submitted without prejudice to the respondent's right to contest the correctness of the decision entered herein by the Court pursuant to the statute in such cases made and provided.

/s/ NELSON P. ROSE, ECC,
Chief Counsel, Internal Revenue
Service.

Of Counsel: Melvin L. Sears, Regional Counsel,
R. E. Maiden, Jr., Special Assistant to the Re-
gional Counsel, Internal Revenue Service.

Without prejudice to the right of appeal, it is agreed that the attached computation is in accordance with the opinion of the Tax Court in the above-entitled case.

/s/ THOMAS A. BAIRD,
Counsel for Petitioner.

Ap:LA:AA-EWM

Computation Statement

In re: Faye Clark, 304 Marguerite, Corona Del Mar, Cali-
fornia.

Docket No. 48543

Income Tax Liability

Year		Payments on			
		Statutory Deficiency	Jeopardy Assessments	Overpayment Tax 50% Penalty	
1945	Tax	None	\$ 370.80	\$ 370.80	_____
	Penalty	None	None	_____	None
1946	Tax	None	5,470.80	5,470.80	_____
	Penalty	None	None	_____	None
1947	Tax	\$9,288.48	5,513.79	None	_____
	Penalty	None	None	_____	None
Totals		\$9,288.48	\$11,355.39	\$5,841.60	None

Overassessment of Jeopardy Assessments

Year	Tax	Interest	50% Penalty
1945	\$ 823.89	\$ 334.89	\$ 411.95
1946	12,157.33	4,212.26	6,078.67
1947	2,964.39	849.24	6,126.44
<hr/>			
Totals	\$15,945.61	\$5,396.39	\$12,617.06

The computation of tax liability shown herein is in accordance with the opinion of The Tax Court of the United States filed July 17, 1957, for decision to be entered under Rule 50.

Year 1945

It has been stipulated that there is no statutory deficiency in assessment for the year 1945 and that there is an overpayment of \$370.80. The adjustments of income and tax liability shown in the deficiency notice dated February 20, 1953, are therefore reversed.

Income tax liability	\$ 1,121.36
Income tax liability disclosed by the return, Account No. 3056461, Los Angeles District	1,121.36
<hr/>	
Statutory deficiency in income tax	None
50% fraud penalty	None

	Tax	50% Fraud Penalty	Interest
Assessed:			
Liability disclosed by the original return, Account No. 3056461, Los Angeles District	\$ 1,121.36	None	None
Jeopardy, Spl. #5, December 24, 1952 List, Page 0, Line 6	823.89	\$ 411.95	\$ 334.89
<hr/>			
Total assessed	\$ 1,945.25	\$ 411.95	\$ 334.89
Liability	1,121.36	None	None
<hr/>			
Overassessment	\$ 823.89	\$ 411.95	\$ 334.89

Adjustment to Net Income

Net income as disclosed by the deficiency notice dated February 20, 1953	\$36,765.23
Additional deduction:	
(a) Farm loss	486.60
Net income as revised	<u>\$36,278.63</u>

Explanation of Adjustment

(a) Net income is decreased \$486.60, representing allowance of deduction for farm loss. Computation of farm loss is as follows:

Income from farm	None
Deductions allowed by opinion of the Tax Court of the United States:	
Year 1946	
Seed wheat	\$274.95
Taxes	223.24
Salary	475.00
	<u>\$ 973.19</u>
Farm loss	<u>\$ 973.19</u>
Petitioner's community one-half	486.60

Computation of Tax

Year 1946

Net income	\$36,278.63
Less: Exemptions	1,000.00
Income subject to tentative tax	<u>\$35,278.63</u>
Tentative tax	\$16,591.11
Less: 5%	829.56
Income tax	<u>\$15,761.55</u>
Deduct:	
Deficiency in income tax barred by statute per opinion of the Tax Court of the United States	<u>11,856.85</u>
Income tax liability	<u>\$ 3,904.70</u>
Income tax liability disclosed by the return, Account No. 3039847, Los Angeles District	<u>3,904.70</u>
Statutory deficiency in income tax	None
50% fraud penalty	None

	Tax	50% Fraud Penalty	Interest
Assessed:			
Liability disclosed by the return, Account No. 3039847, Los Angeles District	\$ 3,904.70	None	None
Jeopardy, Spl. #5, December 24, 1952 List, Page 0, Line 8	12,157.33	6,078.67	4,212.26
Total assessed	\$16,062.03	\$ 6,078.67	\$ 4,212.26
Liability	3,904.70	None	None
Overassessment	\$12,157.33	\$ 6,078.67	\$ 4,212.26

Year 1947

Adjustments to Net Income

Net income as disclosed by the deficiency notice dated February 20, 1953	\$33,781.20
Nontaxable income and additional deduction:	
(a) Unreported dividends	\$4,859.20
(b) Farm loss	161.62
Net income as revised	\$28,760.38

Explanation of Adjustments

(a) Unreported dividends as shown by the deficiency notice	\$49,500.99
Unreported dividends per the opinion of the Tax Court of the United States	39,782.58

Decrease in unreported dividends	\$ 9,718.41
Petitioner's community one-half	4,859.20

(b) Net income is decreased \$161.62, representing allowance of deduction for farm loss. Computation of farm loss is as follows:

Income from farm	None
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Deductions allowed by opinion of the Tax

Court of the United States:

Salary	\$100.00	
Taxes	223.24	323.24

Farm loss		\$ 323.24
Petitioner's community one-half		161.62

Computation of Tax
Year 1947

	Ordinary Rates	Alternative Tax
Net income	\$28,760.38	\$28,760.38
Less: Exemptions	1,000.00	1,000.00
Income subject to tentative tax	\$27,760.38	\$27,760.38
Less: Net long-term capital gain		530.71
Balance of income subject to tax	\$27,760.38	\$27,229.67
Tentative tax	11,831.44	11,502.40
Less: 5%	591.57	575.12
Tax at ordinary rates (not applicable)	\$11,239.87	
Partial tax		10,927.28
Add: 50% of \$530.71, net long-term capital gain		265.36
Alternative tax (lesser tax)		\$11,192.64
Income tax liability		11,192.64
Income tax liability disclosed by the return, Account No. 3050797, Los Angeles District		1,904.16
Statutory deficiency in income tax		\$ 9,288.48
50% fraud penalty		None

	50% Fraud Tax	Penalty	Interest
Assessed:			
Liability disclosed by the original return, Account No. 3050797, Los Angeles District	\$ 1,904.16	None	None

	Tax	50% Fraud Penalty	Interest
Jeopardy, Spl. #5, December 24, 1952, List, Page 1, Line 0	12,252.87	\$ 6,126.44	\$ 3,510.19
Total assessed	\$14,157.03	\$ 6,126.44	\$ 3,510.19
Liability	11,192.64	None	2,660.95
Overassessment (abatable)	\$ 2,964.39	\$ 6,126.44	\$ 849.24

STATEMENT OF ACCOUNT

In re: Faye Clark, 304 Marguerite, Corona Del Mar, California.

Docket No. 48543

Income Tax — Year 1945

	Tax	50% Fraud Penalty	Interest
Paid:			
May 31, 1946	\$ 271.36	None	None
Paid on joint estimated tax:			
March 15, 1945 \$ 250.00			
June 15, 1945 .. 250.00			
Sept. 15, 1945 .. 950.00			
Jan. 15, 1946 .. 250.00			
Total	1,700.00		
Faye Clark's one-half	850.00	None	None
January 18, 1954	370.80	None	None
Totals paid	\$1,492.16	None	None
Liability	1,121.36	None	None
Overpayment (Section 322(d) (1)(D) of the 1939 Internal Revenue Code)	\$ 370.80	None	None

Return filed March 15, 1946.

Deficiency notice dated February 20, 1953.

Claim for refund filed September 20, 1955.

Year 1946

	Tax	50% Fraud Penalty	Interest
Paid:			
March 15, 1947	\$ 2,037.50	None	None
Paid on estimated tax:			
March 15, 1946 \$230.38			
June 17, 1946 .. 230.38			
Sept. 16, 1946 .. 230.38			
Jan. 17, 1947 .. 230.36	921.50	None	None
Tax withheld by employer ..	945.70	None	None
January 18, 1954	5,470.80	None	None
Totals paid	\$ 9,375.50	None	None
Liability	3,904.70	None	None

Overpayment (Section 322(d)

(1)(D) of the 1939 Internal

Revenue Code) \$ 5,470.80 None None

Return filed March 15, 1947.

Deficiency notice dated February 20, 1953.

Claim filed for refund September 20, 1955.

Year 1947

Paid:			
March 15, 1948	\$ 485.34	None	None
Tax withheld by employer	1,418.82	None	None
January 18, 1954	5,513.79	None	None
Totals paid	\$ 7,417.95	None	None
Liability	11,192.64	None	2,660.95
Deficiency in payment	\$ 3,774.69	None	\$2,660.95

[Endorsed]: T.C.U.S. Filed November 13, 1957.

Tax Court of the United States
Washington

Docket No. 48542

GENE O. CLARK,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

DECISION

Pursuant to the Memorandum Findings of Fact and Opinion filed July 17, 1957, the parties on November 13, 1957, having filed an agreed computation of the tax, it is

Ordered and Decided: That there is an overpayment in income tax for the taxable year 1945 in the amount of \$361.75, which amount was paid after the mailing of the notice of deficiency, and that there is no addition to tax under section 293(b), I.R.C. 1939, for the taxable year 1945; and, without considering the jeopardy assessment made prior to the issuance of the notice of deficiency and payments made pursuant thereto, there are deficiencies in income tax and additions to tax under section 293(b), I.R.C. 1939, for the taxable year 1946 in the respective amounts of \$11,752.35 and \$5,876.18, and for the taxable year 1947 in the respective amounts of \$9,141.45 and \$4,570.73.

Entered November 20, 1957.

[Seal] /s/ MORTON P. FISHER,
Judge.

Served and Entered November 21, 1957.

Tax Court of the United States
Washington

Docket No. 48543

FAYE CLARK, Petitioner,
vs.
COMMISSIONER OF INTERNAL REVENUE,
Respondent.

DECISION

Pursuant to the Memorandum Findings of Fact and Opinion filed July 17, 1957, the parties on November 13, 1957, having filed an agreed computation of the tax, it is

Ordered and Decided: That there are overpayments in income tax for the taxable years 1945 and 1946 in the respective amounts of \$370.80 and \$5,470.80, which amounts were paid after mailing the notice of deficiency, and that there are no additions to tax under section 293(b), I.R.C. 1939, for the taxable years 1945 and 1946; and, without considering the jeopardy assessment made prior to the issuance of the notice of deficiency and payments made pursuant thereto, there is a deficiency in income tax for the taxable year 1947 in the amount of \$9,288.48 and there is no addition to tax under section 293(b), I.R.C. 1939, for the taxable year 1947.

Entered November 20, 1957.

[Seal] /s/ MORTON P. FISHER,
Judge.

Served and Entered November 21, 1957.

[Title of Court of Appeals and Tax Docket No. 48542.]

PETITION FOR REVIEW

Gene O. Clark, the petitioner in this cause, by Alva C. Baird and Thomas A. Baird, his counsel, hereby files his petition for a review by the United States Court of Appeals for the Ninth Circuit, of the decision of the Tax Court of the United States on November 20, 1957, pursuant to its Findings of Fact and Opinion promulgated on July 17, 1957 (T.C. Memo 1957-129) ordering and deciding:

“* * * without considering the jeopardy assessment made prior to the issuance of the notice of deficiency and payments made pursuant thereto, there are deficiencies in income tax and additions to tax under section 293(b), I.R.C. 1939, for the taxable year 1946 in the respective amounts of \$11,752.35 and \$5,876.18, and for the taxable year 1947 in the respective amounts of \$9,141.45 and \$4,570.73.”

I.

Jurisdiction

The petitioner, Gene O. Clark, and Faye Clark were husband and wife during the calendar years 1946 and 1947, inclusive, and resided in Los Angeles County, California. All income derived by petitioner during the years 1946 and 1947, inclusive, was community income. For the calendar years 1946 and 1947, petitioner filed separate income tax returns on the community property basis with the Collector of Internal Revenue for the Sixth District

of California (now the Director of Internal Revenue, Sixth Collection District) whose office is located at Los Angeles, California, which collection district is within the jurisdiction of the United States Court of Appeals for the Ninth Circuit, wherein this review is sought.

II.

Nature of Controversy

This controversy involves the proper determination of the petitioner's liability for Federal income taxes for the taxable years 1946 to 1947, inclusive.

Prior to May 1, 1946, petitioner Gene O. Clark and one Archie M. Koyl were engaged in a joint venture doing business under the firm name and style of Gene Clark Plumbing Co. This business consisted of two shops located in El Monte and Bell Gardens, California. The primary business of the Gene Clark Plumbing Co. was the selling of plumbing supplies and rendering plumbing services to building contractors.

On April 23, 1946, petitioner and the said Archie M. Koyl organized a California corporation, Gene O. Clark, Inc., to engage in the wholesale plumbing business. Said corporation actively began business on May 1, 1946. Petitioner Gene O. Clark owned 70% of the outstanding stock of the corporation, and Archie M. Koyl owned 30% of the stock during the period here involved. Gene O. Clark was president of the corporation and Archie M. Koyl was vice president thereof. The corporation occupied

the same premises as the predecessor joint venture, Gene Clark Plumbing Co.

Gene Clark, Inc. kept its books on the accrual method and reported its income on a fiscal year basis beginning with the year ending April 30, 1947.

During each of the years 1946 and 1947, the Commissioner contended that petitioner received monies and property from sales made by the corporation, which were not recorded on its books nor reported in the tax returns of the corporation or the petitioner.

Through the use of an arbitrary formula, the Commissioner determined that petitioner received constructive dividends from Gene Clark, Inc. and added such alleged constructive dividends to petitioner's income for each of the years involved. The Commissioner also contended that there was an omission from gross income in the returns of the petitioner for each of the years 1946 and 1947 of amounts properly includible therein, which were in excess of twenty-five percentum of the amount of gross income stated in said returns, and that each of the returns of the petitioner for the years 1946 and 1947 were false and fraudulent with intent to evade taxes, and further that a part of the deficiency of the petitioner for each of the years 1946 and 1947 was due to fraud with intent to evade taxes.

III.

Statement of Points

The petitioner intends to rely upon the following points in this proceeding:

That the Tax Court of the United States erred:

(1) In holding and finding that petitioner Gene O. Clark was the president and majority stockholder of Gene Clark, Inc. from April 23, 1946 to March 1, 1949, inclusive, and as such was the dominating factor in conducting and controlling its corporate affairs.

(2) In holding and finding that Gene Clark, Inc. received substantial amounts of taxable income from unrecorded sales which it failed to report on its returns.

(3) In holding and finding that petitioner withheld and diverted to his own purposes substantial amounts of the proceeds of the alleged unreported sales.

(4) In holding and finding that petitioner realized unreported income from informal or constructive dividends from Gene Clark, Inc. for the calendar years 1946 and 1947 which he failed to report on his individual tax returns for the years 1946 and 1947.

(5) In holding and finding that the assessment and collection as to petitioner was not barred by the Statute of Limitations as to the years 1946 and 1947.

(6) In holding and finding that each of the returns of the petitioner for the years 1946 and 1947 was false and fraudulent with intent to evade taxes.

(7) In holding and finding that a part of the deficiency of petitioner for each of the years 1946 and 1947 was due to fraud with intent to evade taxes.

(8) In holding and finding that petitioner did not sustain his burden of proof for each of the taxable years 1946 and 1947.

IV.

The petitioner, Gene O. Clark, being aggrieved by the findings of fact and conclusions of law contained in the said findings and opinion of the Court, and by its decision entered pursuant thereto, desires to obtain a review thereof by the United States Court of Appeals for the Ninth Circuit.

/s/ THOMAS A. BAIRD,

Counsel for Petitioner.

Of Counsel: Alva C. Baird, Gerald A. Sheppard,
Albert J. Galen.

Duly Verified.

[Endorsed]: T.C.U.S. Filed February 10, 1958.

[Title of Court of Appeals and Tax Docket No.
48543.]

PETITION FOR REVIEW

Faye Clark, the petitioner in this cause, by Alva C. Baird and Thomas A. Baird, her counsel, hereby files her petition for a review by the United States Court of Appeals for the Ninth Circuit, of

the decision of the Tax Court of the United States on November 20, 1957, pursuant to its Findings of Fact and Opinion promulgated on July 17, 1957 (T.C. Memo 1957-129) ordering and deciding:

“* * * without considering the jeopardy assessment made prior to the issuance of the notice of deficiency and payments made pursuant thereto, there is a deficiency in income tax for the taxable year 1947 in the amount of \$9,288.48 * * *.”

I.

Jurisdiction

The petitioner, Faye Clark, and Gene O. Clark were husband and wife during the calendar year 1947, and resided in Los Angeles County, California. All income derived by petitioner during the year 1947, was community income. For the calendar year 1947, petitioner filed a separate income tax return on the community property basis with the Collector of Internal Revenue for the Sixth District of California (now the Director of Internal Revenue, Sixth Collection District) whose office is located at Los Angeles, California, which collection district is within the jurisdiction of the United States Court of Appeals for the Ninth Circuit, wherein this review is sought.

II.

Nature of Controversy

This controversy involves the proper determination of the petitioner's liability for Federal income taxes for the taxable year 1947.

Prior to May 1, 1946, petitioner's husband, Gene O. Clark, and one Archie M. Koyl were engaged in a joint venture doing business under the firm name and style of Gene Clark Plumbing Co. This business consisted of two shops located in El Monte and Bell Gardens, California. The primary business of the Gene Clark Plumbing Co. was the selling of plumbing supplies and rendering plumbing services to building contractors.

On April 23, 1946, Gene O. Clark and the said Archie M. Koyl organized a California corporation, Gene O. Clark, Inc., to engage in the wholesale plumbing business. Said corporation actively began business on May 1, 1946. Gene O. Clark owned 70% of the outstanding stock of the corporation, and Archie M. Koyl owned 30% of the stock during the period here involved. Gene O. Clark was president of the corporation and Archie M. Koyle was vice president thereof. The corporation occupied the same premises as the predecessor joint venture, Gene Clark Plumbing Co.

Gene Clark, Inc. kept its books on the accrual method and reported its income on a fiscal year basis beginning with the year ending April 30, 1947.

During each of the years 1946 and 1947, the Commissioner contended that petitioner's husband, Gene O. Clark, received monies and property from sales made by the corporation, which were not recorded on its books nor reported in the tax returns of the corporation, or the petitioner, or her husband, Gene O. Clark.

Through the use of an arbitrary formula, the Commissioner determined that petitioner and her husband received constructive dividends from Gene Clark, Inc. and added one-half of such alleged constructive dividends to petitioner's income for each of the years involved. The Commissioner also contended that there was an omission from gross income in the return of the petitioner for the year 1947 of amounts properly includible therein, which were in excess of twenty-five percentum of the amount of gross income stated in said return.

III.

Statement of Points

The petitioner intends to rely upon the following points in this proceeding:

That the Tax Court of the United States erred:

(1) In holding and finding that petitioner's husband, Gene O. Clark, was the president and majority stockholder of Gene Clark, Inc. from April 23, 1946 to March 1, 1949, inclusive, and as such was the dominating factor in conducting and controlling its corporate affairs.

(2) In holding and finding that Gene Clark, Inc. received substantial amounts of taxable income from unrecorded sales which it failed to report on its returns.

(3) In holding and finding that petitioner and her husband, Gene O. Clark, withheld and diverted to their own purposes substantial amounts of the proceeds of the alleged unreported sales.

(4) In holding and finding that petitioner and her husband, Gene O. Clark, realized unreported income from informal or constructive dividends from Gene Clark, Inc. for the calendar year 1947 which they failed to report on their individual tax return for the year 1947.

(5) In holding and finding that the assessment and collection as to petitioner was not barred by the Statute of Limitations as to the year 1947.

(6) In holding and finding that petitioner did not sustain her burden of proof for the taxable year 1947.

IV.

The petitioner, Faye Clark, being aggrieved by the findings of fact and conclusions of law contained in the said findings and opinion of the Court, and by its decision entered pursuant thereto, desires to obtain a review thereof by the United States Court of Appeals for the Ninth Circuit.

/s/ THOMAS A. BAIRD,
Counsel for Petitioner.

Of Counsel: Alva C. Baird, Albert J. Galen,
Gerald A. Sheppard.

Duly Verified.

[Endorsed] T.C.U.S. Filed February 10, 1958.

[Title of Court of Appeals and Tax Docket No. 48542.]

NOTICE OF FILING PETITION
FOR REVIEW

To: Nelson P. Rose, Chief Counsel, Internal Revenue Service, Washington, D. C.

You are hereby notified that the petitioner on the 7th day of February, 1958, filed with the Clerk of The Tax Court of The United States at Washington, D.C., a petition for review by the United States Court of Appeals for the Ninth Circuit of the decision of the Tax Court of the United States heretofore rendered in the above-entitled cause. A copy of the Petition for Review and the assignments of error as filed is hereto attached and served upon you.

Dated at Los Angeles, California, this 7th day of February, 1958.

Respectfully,

/s/ THOMAS A. BAIRD,
Counsel for Petitioner.

Acknowledgment of Service Attached.

[Endorsed]: T.C.U.S. Filed February 17, 1958.

[Note: Notice of Filing Petition for Review in Docket No. 48543 is the same as in Docket No. 48542.]

[Title of Tax Court and Docket Nos. 48542-3.]

ORDER ENLARGING TIME

For cause, it is

Ordered: That the time for filing the record on review and docketing the petitions for review in the United States Court of Appeals for the Ninth Circuit is extended to May 11, 1958.

Dated: Washington, D. C., March 3, 1958.

[Seal] /s/ J. E. MURDOCK,
Judge.

Served March 3, 1958.

The Tax Court of the United States

Docket Nos. 48542, 48543, 48544

GENE O. CLARK, FAYE CLARK, GENE O.
CLARK and FAYE CLARK, Petitioners,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

STIPULATION OF FACTS

The parties hereto, through their respective counsel hereby stipulate and agree to the facts hereinafter set forth:

1. That the income tax returns of the Petitioners for the taxable years 1945 to 1949 inclusive, were prepared and filed on the cash basis and for

a calendar year accounting period. All income tax returns of the Petitioners for said period 1945 to 1949 inclusive were filed on the 15th day of March following the close of the calendar year. No agreements extending the statute of limitations on assessment or collection were entered into between the Petitioners and the Respondent for the taxable year 1945, 1946 or 1947. An agreement extending the statute of limitations was executed by the parties for the calendar year 1948. With reference to the taxable years 1948 and 1949 the statute of limitations is not an issue.

2. That on or about December 24, 1952, the Respondent made jeopardy assessments against the Petitioners herein, for the deficiencies and penalties as set forth in the statutory notices of deficiency.

3. That on or about January 14, 1954, the Petitioners forwarded their cashier's check in the amount of \$34,670.81 to the Director of Internal Revenue at Wichita, Kansas, together with instructions to apply same against said jeopardy assessment. The Director received said check and credited said assessment as follows:

Year	Gene Clark	Faye Clark	Gene O. Clark and Faye Clark
1945	\$ 361.75	\$ 370.80	
1946	5,423.91	5,470.80	
1947	5,444.42	5,513.79	
1948			\$8,901.26
1949			3,147.96

4. That Gene Clark, Inc., a California corporation, was organized on May 1, 1946 as successor

to Gene Clark Plumbing Company. There were authorized and issued 522 shares of stock. These shares of stock were issued in the following manner:

364 shares to Gene O. Clark

157 shares to Archie M. Koyl

On or about March 31, 1948, Gene O. Clark purchased 157 shares of stock owned by Archie M. Koyl, and at that time owned 100% of the stock. On or about March 1, 1949, Archie M. Koyl purchased 262 shares and Fawn A. Koyl purchased 260 shares, making a total of 522 shares, of the stock of Gene Clark, Inc., a corporation, from Gene O. Clark.

5. That on or about May 1, 1946, Gene O. Clark acquired 364 shares of common stock in Gene Clark, Inc., at a cost of \$36,500.00; and that on or about March 31, 1948, Gene O. Clark purchased 157 shares of common stock in Gene Clark, Inc., at a cost of \$24,714.49; and that the total cost of the 521 shares was \$61,214.49.

6. That the Petitioners sustained a loss on farm operations in the taxable year 1948 in the amount of \$17,233.05, and that said loss shall be allowed in any recomputation of tax liability for said year.

7. That the Petitioners sustained a loss on farm operations in the taxable year 1949 in the amount of \$17,060.52, and that said loss shall be allowed in any recomputation of tax liability for said year.

8. That the Petitioners sustained a net operating loss in 1950 in the amount of \$4,513.62, which amount is properly allowable as a loss carryback

to the year 1949. Said loss carryback shall be allowed in any recomputation of deficiencies for the taxable year 1949.

Respectfully submitted.

/s/ ALVA C. BAIRD,

Counsel for Petitioners.

Of Counsel: Thomas A. Baird, Frank W. Mahoney.

/s/ R. P. HERTZOG, ECC.,

Acting Chief Counsel, Internal Revenue Service,
Counsel for Respondent.

[Endorsed]: T.C.U.S. Filed March 30, 1955.

[Title of Tax Court and Dockets Nos. 48542-3.]

CERTIFICATE

I, Howard P. Locke, Clerk of the Tax Court of the United States, do hereby certify that the foregoing documents, 1 to 61, inclusive, constitute and are all of the original papers as called for by the "Designation of Contents of Record on Review" (but excluding the exhibits which are separately certified) on file in my office as the original and complete record in the cases before the Tax Court of the United States docketed at the above numbers and in which the petitioners in the Tax Court have filed petitions for review as above numbered and entitled, together with a true copy of the docket entries in said Tax Court cases, as the same appear in the official docket in my office.

In testimony whereof, I hereunto set my hand

and affix the seal of the Tax Court of the United States, at Washington, in the District of Columbia, this 4th day of March, 1958.

[Seal] /s/ HOWARD P. LOCKE,
Clerk, Tax Court of the
United States.

[Title of Tax Court and Docket Nos. 48542-3.]

STIPULATION

It is hereby stipulated by and between counsel for the respective parties that the testimony of Revenue Agent Donald E. Phillips in the cases of Archie M. Koyl, et al., v. Commissioner of Internal Revenue, T. C. Docket Nos. 48336, 48337 and 48338, on March 29 and 30, 1955, pages 156 to 269, inclusive of the transcript of testimony in said cases, shall be certified and transmitted by the Clerk of the Tax Court of the United States to the Clerk of the United States Court of Appeals for the Ninth Circuit as part of the Record on Review in this proceeding.

Dated: May 26, 1958.

/s/ THOMAS A. BAIRD,
Counsel for Petitioner.

/s/ ARCH M. CANTRALL,
Chief Counsel, Internal Revenue Service, Counsel
for Respondent.

[Endorsed]: T.C.U.S. Filed May 29, 1958.

[Title of Tax Court and Docket Nos. 48542-3.]

CERTIFICATE

I, Howard P. Locke, Clerk of the Tax Court of the United States, do hereby certify that the foregoing original documents numbered 62 and 63, on file in my office, constitute (1) pages 156 to 269, inclusive, of the transcript of the trial in the cases of Archie M. Koyl, et al., T. C. Docket Nos. 48366, 48337, and 48338, said pages containing the testimony of Donald E. Phillips, and which testimony was incorporated as evidence in the record in the above-entitled cases, so far as relevant; and (2) stipulation for supplemental record, which original documents constitute a supplemental record on this review, pursuant to said stipulation.

In testimony whereof, I hereunto set my hand and affix the seal of the Tax Court of the United States, at Washington, in the District of Columbia, this 2nd day of June, 1958.

[Seal] /s/ HOWARD P. LOCKE,
Clerk, Tax Court of the
United States.

In The Tax Court of the United States

Docket No. 48542

Gene O. Clark, Petitioner, vs. Commissioner of
Internal Revenue, Respondent.

Docket No. 48543

Faye Clark, Petitioner, vs. Commissioner of In-
ternal Revenue, Respondent.

Docket No. 48544

Gene O. Clark and Faye Clark, Petitioners, vs.
Commissioner of Internal Revenue, Respond-
ent.

TRANSCRIPT OF PROCEEDINGS

Courtroom No. 9, U. S. Post Office, Los Angeles,
California, Wednesday, March 30, 1955.

The above-entitled matter came on for hearing,
pursuant to notice to the parties, at 12:10 o'clock
p.m. [1]*

Before: Honorable Morton P. Fisher, Judge Pre-
siding.

Appearances: Alva C. Baird, Esq., and Thomas
A. Baird, Esq., 458 South Spring Street, Los Ange-
les 13, California, for the Petitioners. Sidney J.
Machtinger, Esq., and J. Earl Gardner, Esq. (Hon.

* Page numbers appearing at top of page of Reporter's Tran-
script of Record.

Daniel A. Taylor, Chief Counsel, Internal Revenue Service), for the Respondent. [2]

* * * * *

PARIS B. CLAYPOOLE

was called as a witness by and on behalf of the petitioners, and, having been first duly sworn, was examined and testified as follows:

Direct Examination

The Clerk: State your name and address, please.

The Witness: Paris, P-a-r-i-s, B., Claypoole, [23] C-l-a-y-p-o-o-l-e, 619 East Foothill, Altadena, California.

Q. (By Mr. T. Baird): Mr. Claypoole, will you state your present occupation?

A. I am an accountant licensed to practice in California.

Q. Public accountant? A. Yes.

Q. Will you tell the Court a little of your background? Where did you go to school?

A. I attended public schools of Cincinnati, Ohio and the University of Cincinnati for about two years immediately preceding World War I.

Q. Then what happened? What did you do after that?

A. After leaving military service at the beginning of 1919, I was assigned to the War Department Ordnance Section for accounting duties for approximately six months until I was appointed traveling auditor for the Bureau of Internal Revenue and for some two years I was a traveling

(Testimony of Paris B. Claypoole.)

auditor and, thereafter, an Internal Revenue agent until December 31st, 1953, when I retired.

Q. What did you do with the Bureau of Internal Revenue, Mr. Claypoole?

A. My duties in the Bureau consisted of the examination of income tax returns of all classifications, principally corporations and individuals and, specifically, for about 25 years I was either engaged in or supervised the examinations of cases [24] in which fraud was alleged by the Government.

* * * * *

Q. Mr. Claypoole, I show you a schedule which is entitled "Gene Clark, Inc., Fiscal Year April 30, 1947, Analysis of Income Available for Distribution to Stockholders for Fiscal Year Ended April 30, 1947, Based on Report of Revenue Agent D. E. Phillips (February 4, 1953)—Said Report Being the Basis of the 90-Day Letter." Did you prepare this schedule, Mr. Claypoole? A. I did.

Q. And what did you prepare the schedule from?

A. I prepared that from the Revenue Agent's report, the income tax return of the corporation for the fiscal year ended 4/30/1947 and related that to the returns of the individuals, [25] Gene and Faye Clark.

Q. In other words, this is an analysis of Mr. Phillips' computations? A. Entirely so.

Mr. T. Baird: I would like to have this marked as petitioners' exhibit next in order.

(Testimony of Paris B. Claypoole.)

The Clerk: Petitioners' Exhibit 15 marked for identification.

* * * * *

Q. (By Mr. T. Baird): Mr. Claypoole, the first item that we come to on this schedule is Income Per Tax Return. Where did you get the amount of \$30,632.10? Where did you get that figure from?

A. That figure is taken from two places, first, the income, the net income reported by the corporation on its tax return for the fiscal year April 30, 1947, and also from Schedule 1, page 5 of Revenue Agent Phillips' report on the corporation.

Q. In other words, does that figure reflect the income that was reported on the tax return of the corporation? A. It does. [26]

Q. The next item we come to is Add Adjustments to Taxable Income in the amount of \$102,050.17. Where did you get this figure from, Mr. Claypoole?

A. That figure came from the Schedule 1, page 5, of the Internal Revenue Agent's report on the corporation.

Q. Was that figure also reflected in Schedule Q of said report, Mr. Claypoole? A. Yes, sir.

Q. The next item we come to is Net Income Per RAR, \$132,682.27. Is that the net income that Revenue Agent Phillips arrived at for the fiscal year April 30, 1947, Mr. Claypoole?

A. Yes, it is.

Q. And where did you find that figure in his report?

(Testimony of Paris B. Claypoole.)

A. That figure appears in Schedule 1, page 5, of the Revenue Agent's report.

Q. I notice the next item is Less: Income Not Available for Distribution Per Books, Tax Return and RAR, in the Amount of \$30,632.10. Can you explain, Mr. Claypoole, why that is not available for distribution per the books, tax returns and RAR and where did you get the figure, if I may ask a compound question?

A. The \$30,000 is the net income reported by the corporation for its fiscal year April 30, 1947. It is the net result as reflected in the balance sheet of the corporation with [27] the tax return which in turn discloses how and what the corporation did with the \$30,000.

Q. And I see that you have subtracted that from the net income and arrived at a figure of \$102,050.17—

* * * * *

Q. (By Mr. T. Baird): Where does that figure, \$102,050.17 show in the Revenue Agent's report, Mr. Claypoole?

A. That figure is taken from Exhibit Q, page 81 of the Revenue Agent's report.

Q. Do you have a copy of the Revenue Agent's report with you? A. Yes, sir.

Q. Will you show that figure to His Honor and where you are looking on Schedule Q? Will you let the Judge keep that for a while, Mr. Claypoole?

The Court: Go ahead.

Mr. T. Baird: Thank you.

(Testimony of Paris B. Claypoole.)

Q. (By Mr. T. Baird): The next items that we come to you have identified as Items Not Available for Distribution Per Exhibit Q and you have a list of items listed in your schedule, the first one of which [28] is Truman Johnson deal, \$6,000. Is that reflected in Schedule Q, Mr. Claypoole?

A. That is reflected in Schedule Q as part of a total of \$63,488.47. It is broken down in Exhibit Q-1, page 83, which is the explanation of the \$63,000 item.

* * * * *

Q. (By Mr. T. Baird): Are all of the rest of the items, the H. L. Brittian transaction in the amount of \$1,860.40, the deferred income item of \$49,210.15, the merchandise account in the amount of \$2,714.42, bad debts in the amount of \$3,703.50, are these also reflected and make up the figure \$63,488.47, Mr. Claypoole?

A. They do.

Q. And was this figure entitled by Revenue Agent Phillips in Schedule Q as Adjustments to Net Income Not Available?

A. It was.

Q. And where else in the report is there a subtitle to Schedule Q, Mr. Claypoole? Is there a Q-1, for instance?

A. Yes, Exhibit Q-1, page 83, is the explanation sheet for Exhibit Q, page 82 and 82.

Q. And are all the items listed on your schedule that I have just mentioned listed in Q-1 of the Revenue Agent's [29] report?

A. They are.

Q. As not being available for distribution?

(Testimony of Paris B. Claypoole.)

A. Yes, sir.

Q. I see that you have subtracted these Items Not Available for Distribution Per RAR from the \$102,000 and arrive at a figure of \$38,561.70. Then I see that you have—what is the next step that you took after that, Mr. Claypoole?

A. The next step is to apply that figure, the amount of income tax set-up in the Revenue Agent's report as the income tax applying to the \$132,682.27. That is found on page 19 of the Revenue Agent's report.

* * * * *

Q. Was the amount \$38,561.70 under your heading Items [30] Not Available for Distribution Per Exhibit Q and under Mr. Phillips' Item B of Schedule Q, Adjustments to Net Income Not Available, were those items taken into consideration in the deficiency notice?

Mr. Machtinger: Objection, I object to the use of the word "taken into consideration". Does he mean by the agent or whether they were computed on the return of just what is the meaning of the term "taken into consideration"?

Q. (By Mr. T. Baird): Were these accounting adjustments taken into consideration in the 90-day letter as well as upon Schedule Q from your analysis? A. These—

Mr. Machtinger: Are you asking his opinion?

Mr. T. Baird: I am asking what he found from his analysis.

The Court: Well, I don't quite get what you are

(Testimony of Paris B. Claypoole.)

referring to. The stipulation is that for the purpose of determining the basis of calculations, the Revenue Agent's report is admitted in evidence and that the Revenue Agent's report is the basis for the statutory notice of deficiency.

Mr. T. Baird: That is correct, your Honor.

The Court: Now, are you directing this witness' attention to some element in which the statutory notice of deficiency differs from the Revenue Agent's report or what? [31]

Mr. T. Baird: I am, your Honor.

The Court: You are?

Mr. T. Baird: I am.

The Court: All right, let's make it clear so he's got it before him. Let's see what it means.

Q. (By Mr. T. Baird): From your analysis, Mr. Claypoole, I will ask again, did you find that these items were taken into consideration in the deficiency notice?

A. They were not as such considered as—well, strike that. They were treated as available for distribution in the statutory notice.

Q. But were they adjusted and deducted from that amount available for distribution?

A. No, sir.

Mr. Machtinger: Excuse me, could you please identify the word "they"? 'I have lost——

Mr. T. Baird: Well, we have been referring to the items not available for distribution per Exhibit

Q. I have also referred to it in Exhibit Q as Item D, adjustments to net income, in the amount of

(Testimony of Paris B. Claypoole.)

\$63,000. I also refer you to Schedule Q-1 where you find the same figures.

Q. (By Mr. T. Baird): And the amount of Federal income tax per RAR in the amount of \$50,419.26, from your analysis, Mr. Claypoole, can [32] you state whether or not this item was taken into consideration as a deduction before arriving at the figure Net Income Available for Distribution? A. In part.

Q. In the deficiency notice? A. In part.

Q. In part. And what part? Have you a breakdown on that?

A. Yes, sir. In the Revenue Agent's report, he used an item of \$43,885.88 as reduction surplus available for distribution, whereas in his report he shows the tax at \$50,419.26.

Q. Well, now, Mr. Claypoole, this may be repetitious, but where in the report does he show \$50,419.26 as a proper deduction?

A. On page 19 of the Revenue Agent's report.

Q. Does he show anywhere in the Revenue Agent's report a deduction of \$43,000 some-odd dollars? A. Yes, he does.

Q. —\$885.88. Where does he show that in the report, Mr. Claypoole?

A. He shows that on page 19 and also on the statement of tax liability as deficiency tax.

Q. Well, have you been able to reconcile these two figures or arrive at any accounting method of the difference of why in one instance \$50,419.26 was subtracted from available [33] net income and

(Testimony of Paris B. Claypoole.)

on the other hand in another portion of his report only \$43,885.85 was deducted from available net income? A. Yes, I have.

Q. What is that, Mr. Claypoole?

A. The difference between the \$43,885.85 and \$50,419.26 is \$6,533.38. On the original tax return filed or on the tax return filed by the corporation, the tax was determined as \$8,735.01. In 1950, the examination of the tax return was made by a Revenue Agent resulting in a refund to the corporation on its 1947 return of \$2,201.63. The difference between what they paid originally and the amount refunded makes the \$6,533.38 difference between these figures as I have indicated.

Q. In other words, from your analysis, Mr. Claypoole, the agent did not take into consideration the tax already paid?

Mr. Machtinger: Objection. I don't see that this witness can testify as to what the agent did not take into account. He might testify as to any differences between the agent's report and his own report.

Mr. T. Baird: I am asking from his analysis, your Honor.

The Court: Well, this witness is making a calculation based on a calculation. So far as I have been able to see, his calculation is based on a calculation that everybody agrees is wrong and has agreed was wrong right straight through. Then the parties stipulate that the Revenue Agent's report is [34] the basis for the 90-day letter and then

(Testimony of Paris B. Claypoole.)

this witness says that the one isn't based on the other in some respects. Then he points out that somewhere in the Revenue Agent's report which is admitted not for the purpose of the facts but for the purpose of the calculation, there is something to the effect that certain items are not available for distribution.

Then he testifies that the paramount determination which is the statutory notice of deficiency doesn't hold that these items are not to be taken into account. Now, where we are at this moment, I don't know. I assume it would be unraveled, but this far all I can see is a calculation which may later prove to be of interest.

Mr. T. Baird: May I continue?

The Court: Yes, indeed.

Q. (By Mr. T. Baird): Mr. Claypoole, the next item on your schedule, Exhibit 15, is Income Available for Distribution—Nothing. What figure have you arrived at as available for distribution by the corporation, Gene Clark, Inc.?

A. This calculation shows nothing available but, in fact, a deficit of \$11,857.56.

Q. The next item you have is Total Distribution Per RAR, and what does that show?

A. That shows in Exhibit Q, page 81, that the Revenue Agent determined \$74,984.76 available for distribution. [35]

Q. In summary, Mr. Claypoole, how did you arrive at the deficit of \$11,857.56 whereas the Rev-

(Testimony of Paris B. Claypoole.)

Revenue Agent arrived at an amount available for distribution of \$74,984.76?

A. He did not relate Exhibit Q to the surplus account of the corporation.

Q. Where is that surplus account in the report?

A. The surplus account is Exhibit D, page 58 of the Revenue Agent's report.

Q. Looking down, now, at your schedule, I see you have here Constructive Dividend to Gene and Faye Clark Per 90-Day Letters and a breakdown of what was determined by the Revenue Agent to be distributed to Gene Clark and Faye Clark in the calendar years 1946 and 1947. Where did you get those figures, Mr. Claypoole?

A. Those figures came from the Revenue Agent's reports on Gene and Faye Clark and from the statutory notice of deficiencies.

Q. Now I see over in the far right-hand column a total of these two years in the amount of \$91,728.12. Did you get that figure from the same place?

A. That is just the total of these, the \$91,000 does not appear as such in either report but is just a total of the amounts appearing in the two reports, in the statutory notices.

Q. Mr. Claypoole, it is obvious from your schedule that there is a difference in the Revenue Agent's report of the [36] amount available for distribution and that as is shown in the 90-day letter. Just so the record may show, will you state, have

(Testimony of Paris B. Claypoole.)

you arrived at the difference between those two figures? A. Yes, sir.

Q. What is that difference, Mr. Claypoole? In other words, I mean mathematically, what difference? Do you have that figure before you?

A. No, I haven't made that calculation.

Q. Do not take the time. Just state what the distribution per RAR shows as available for distribution. A. \$74,984.96

Q. And what does the statutory notice of deficiency show?

A. The total is \$91,728.12.

Q. Have you tried to through accounting methods to reconcile the differences between these two figures?

A. Well, I know wherein the differences arose, what created the differences.

Q. And what were those determinations, Mr. Claypoole?

Mr. Machtinger: Mr. Baird, will you ask the witness to point out where the \$91,000 figure is on the notice of deficiency?

The Court: Well, I assume it must be an accumulation of a number of figures. You have got two taxpayers and two different years involved.

* * * * * [37]

Q. (By Mr. T. Baird): Do you know what the question is, Mr. Claypoole?

A. Yes, sir. In the Revenue Agent's report, in the surplus account, he used \$132,682.27 as the correct taxable net income. He reduced that by

(Testimony of Paris B. Claypoole.)

income taxes of \$43,885.88 and another item of \$2,714.42.

Q. Mr. Claypoole, may I interrupt you for a moment? Would it be easier for you to testify if we went to the next schedule?

A. Well, I am using the next schedule, sir.

Q. I know, that is why I asked.

Mr. Claypoole, I show you a schedule entitled "Gene Clark, Inc., Fiscal Year April 30, 1947," with the heading "Comparative Analysis of Surplus for Year Ended April 30, 1947, Based Upon Report of Examination by Revenue Agent Don E. Phillips and 90-Day Letter Showing Amount Available for Distribution as a Constructive Dividend." Did you prepare this schedule, Mr. [38] Claypoole?

A. Yes, sir.

Q. Where did you get the figures that are in that schedule?

A. From the Revenue Agent's report and tax return and the 90-day letters.

Mr. T. Baird: I would like, first of all, to enter Exhibit 15 into evidence as Petitioners' Exhibit No. 15.

Mr. Machtinger: We have no objection to it being offered in evidence, your Honor.

The Clerk: Petitioners' Exhibit No. 15 admitted in evidence.

(Petitioners' Exhibit No. 15 was received in evidence.)

Mr. T. Baird: I would now like this comparative analysis, the last schedule, marked for identification.

(Testimony of Paris B. Claypoole.)

The Clerk: Petitioners' Exhibit 16 marked for identification.

(Petitioners' Exhibit No. 16 was marked for identification.)

Mr. T. Baird: Do you have a copy, counsel, of this?

Mr. Machtinger: I have a copy of 15.

Mr. T. Baird: I gave you two.

Q. (By Mr. T. Baird): Now, Mr. Claypoole, referring to the last question, [39] I believe that all involved will be able to follow your answers to that last question of how the difference between what was stated as the amount available for distribution on the 90-day letter and that available for distribution in the Revenue Agent's report differs. What items did you observe from your analysis of the Revenue Agent's report? What did you observe was taken into consideration by Revenue Agent Phillips in arriving at his figure?

A. In this surplus analysis, only two items were considered after the use of the corrected taxable net income of \$132,682.27. They deducted income taxes and an item called Merchandise Purchases, \$2,714.42.

Q. Did he also—I see from your schedule he deducted certain dividends, I assume constructive dividends set up by the agent.

A. Those figures shown as Gene Clark, \$52,489.47, came from Exhibit Q. The one for Archie Koyl, \$22,495.49, came from Exhibit Q.

Q. Just for the record, when we refer to Exhibit

(Testimony of Paris B. Claypoole.)

Q, do you mean of the Revenue Agent's report?

A. Yes, sir.

Q. Now, looking across down at the item Merchandise Purchases, wherein in the report does that show up besides Exhibit Q?

A. That is in Exhibit D, a surplus charge. [40]

Q. At what page? A. 58.

Q. Now, looking at the Truman Johnson transaction, is that also shown on Exhibit D, page 58 of the Revenue Agent's report? A. No, sir.

Q. Is it shown as a proper deduction from surplus elsewhere in his report?

A. In Exhibit Q.

Q. And at any place in the report of an explanation of Exhibit Q?

A. Exhibit Q-1, page 83.

Q. And the other items, H. L. Brittian transaction, deferred income, and bad debt adjustment, are those also taken into consideration by Revenue Agent Phillips on Exhibit Q and explanatory Q-1?

A. Yes, sir.

Q. Are they taken into consideration by Mr. Phillips in his surplus exhibit on page 58?

A. No, sir.

Q. Of his report. From an accounting sense, Mr. Claypoole, can you see any reason why these items should have been taken into consideration in arriving at the distributable net income?

A. They were items determined to not be available for [41] distribution in this year ended April 30, 1947.

(Testimony of Paris B. Claypoole.)

Q. Well, what I am getting at is would you as an accountant consider the item Truman Johnson transaction not available for distribution? Are you familiar with that transaction, Mr. Claypoole?

A. Yes, sir.

Q. Would you consider the \$6,000 as represented by that transaction available for distribution?

A. No, sir, it is not available for distribution.

Q. Why?

A. Because it was stated to represent an investment in real estate which the corporation owned. It was a corporate asset the way it was treated in the Revenue Agent's report.

Q. Well, isn't it possible to distribute a house?

A. Well, it was not distributed in the year 4/30/47.

Q. And what is, to your knowledge, the H. L. Brittian transaction?

A. That is an account receivable, the details of which I am not familiar with.

Q. And then, to your knowledge, the deferred income item?

A. That is an accounting adjustment which was deferred income.

Q. What do you mean by deferred income? What does the Revenue Agent Phillips mean by deferred income in this particular case? [42]

A. In this case, it was income collected on work to be performed or partially completed, work which had not been completed in the year ended April 30, 1947.

Q. How was that item carried on the books and

(Testimony of Paris B. Claypoole.)

records of Gene Clark, Inc. as you have seen the records or the corporation tax return?

A. As a liability.

Q. Would you, as an accountant, say that that figure of deferred income would represent an amount available for distribution?

A. I would say it would not represent an amount available for distribution in the year April 30, 1947.

Q. Well, Mr. Claypoole, isn't it true that these parties may have had cash in that amount, they received it in the year, possibly, let's say, 1946.

A. They may have had cash, this may have been represented by cash in part, at least.

Q. Well, the part that was represented by cash, would you consider that, as an accountant would you consider that or would you advise somebody that they could treat that as available for distribution?

A. I would advise them that it was not available for distribution.

Q. Why?

A. Because the work hadn't been completed. There was [43] work to be performed under the various contracts.

Q. Do you know what this item Bad Debt Adjustment is, Mr. Claypoole?

A. It is, so far as I can tell from the Revenue Agent's report, a reversal of a bad debt charge-off.

Q. I get down now to a figure of \$30,632.10. You state here on your schedule income not avail-

(Testimony of Paris B. Claypoole.)

able for distribution per books, tax return and RAR. Wherein does the Revenue Agent's report say that that is not available for distribution?

A. That is reflected in the balance sheet of the corporation and the corporation's tax return which shows precisely what the \$30,000 was used for by the corporation.

Q. And do you say that from your analysis you have determined that Revenue Agent Phillips took that into consideration at least at one point in his report?

A. At one point, yes, sir, in Exhibit Q.

Q. Did he not take it into consideration in some other place in the report?

A. He did not take it into consideration in the surplus account.

Q. And where is that located in the report? To refresh your memory, is that page 58?

A. Page 58 of the Revenue Agent's report.

Q. I see from your analysis that you arrived at a surplus after deducting these items we have just gone through [44] very carefully plus income taxes in the amount of \$43,885.88, and dividends, he arrived at a surplus of \$11,097.01, while you arrive at a deficit surplus of \$11,857.56. How do you explain that, Mr. Claypoole?

A. Well, he did not take into the surplus account those items not available for distribution or he did not show them in any schedule which would represent a surplus reserve not available for distribution.

(Testimony of Paris B. Claypoole.)

Q. Well, what precisely? What income items were used by Revenue Agent Phillips to show surplus available for constructive dividends for the fiscal year April 30, 1947 according to your analysis of his reports? A. After a deduction—

Mr. Machtinger: If the Court pleases, is the witness now testifying from a specific exhibit of the Revenue Agent?

Mr. T. Baird: Yes, we are down at the bottom of this exhibit.

Mr. Machtinger: Right now in this answer, I would like to know to what exhibit you are referring of the Revenue Agent.

The Witness: May I have that question again?

Q. (By Mr. T. Baird): I would like to know what income items your analysis shows Revenue Agent Phillips to have taken into consideration to show surplus available for constructive dividend distribution [45] as of April 30, 1947.

A. He used—

Q. Well, now in answer to Mr. Machtinger's question, wherein in the Revenue Agent's report are you going to find these figures?

A. Exhibit D, page 58.

Q. Shows what?

A. He used \$132,682.27 and deducted from that income taxes and the item of \$2,714.42 and charged against surplus \$52,489.47 and \$22,495.49. Now, he had previously showed that in Exhibit Q there were certain items not available for distribution which are, as he treated it in effect, a reserve

(Testimony of Paris B. Claypoole.)

charge against surplus for the year April 30, 1947.

Q. Well, at the bottom of your schedule, Mr. Claypoole, you have a list of items here that you claim on the schedule were used by Revenue Agent Phillips. That is what my question was directed to. I don't believe you answered it specifically. The items listed at the bottom of your schedule on Petitioners' Exhibit 16, the same items that we have been talking about that you claim were not taken into consideration in Exhibit D on page 58.

A. The explanation is this. When you use \$132,000 as the income surplus credit and you charge against the income taxes and those items are of \$30,632.10 which were not available for distribution, you arrive at a result which means that [46] you have to find out what items were used and by going back to that you find first there was an error made in the matter of stated income taxes of \$6,533.38. If Mr. Phillips had used the correct figure or——

Mr. Machtinger: I object to that testimony.

The Court: Well, he is giving his opinion. It doesn't mean Mr. Phillips is wrong. It means that this witness is expressing his view. Mr. Phillips will get a chance to justify his figures, if necessary.

Q. (By Mr. T. Baird): Go on, Mr. Claypoole.

A. If Mr. Phillips had used the \$50,419.26 instead of the \$43,885.88, there would have been \$6,533.38 less available for distribution. Had Mr. Phillips charged against the available surplus the \$6,000 item as not available for distribution, there

(Testimony of Paris B. Claypoole.)

would have been \$6,000 less. The same thing is true of the \$1,860.40, the \$49,210.15, and the \$3,703.50 item.

Q. Mr. Claypoole, isn't it true, if Mr. Phillips didn't use any amount as a deduction that it would, of course, make less available for distribution? What I am getting at is do you believe that the amounts that Mr. Phillips showed on Q-1 of his report and on Schedule Q were sound from an accounting sense as to make adjustments to what was available for distribution? Do you believe those were sound for distribution? Do you believe those were sound from the accounting sense? [47]

A. I do.

Q. You believe that they could have been treated as available for distribution from an accounting sense?

A. I do not believe they could have been treated as available for distribution or properly treated as available for distribution.

Q. All right, Mr. Claypoole, we arrive now at a total figure of \$97,939.53, as you have shown on your schedule. What does that figure represent?

A. That is a figure out of which the \$74,984.96 shown on Exhibit Q was taken.

Q. And is that the same figure, is that a total of the same figures that were used in the deficiency notices for the years 1946 and 1947?

A. Do you refer to the \$74,000 item?

Q. I refer to the \$97,000.

A. No, sir, that is not.

(Testimony of Paris B. Claypoole.)

Q. You show a figure, Amount Not Used in Computation, \$22,954.57. What do you mean by that?

A. There was \$97,939.53 of income from which, against which the \$74,984.96 was applied. Now the difference is \$22,954.57.

Q. Have you been able to arrive at any conclusion or opinion as to where that \$22,000 came from? A. Yes, sir. [48]

Q. Where did that come from?

A. The \$22,000 is made up of two items and Mr. Phillips' Exhibit D, page 58, he shows a surplus of \$11,097.01 whereas by using these figures, the way they are used in this testimony, there was a deficit of \$11,857.56. Now, those two figures total \$22,954.57.

Q. Just so the record will not be confused, Mr. Claypoole, any more than it has to be, you have here Dividend Per 90-Day letter, \$74,984.96. Where did you get that figure from?

A. That is a figure which came from Exhibit Q which was broken down on the basis of—came from Exhibit Q as distributable both Clark and Koyl.

* * * * *

Q. (By Mr. T. Baird): I see you have a \$74,000 figure on Exhibit 16 and on Exhibit 15, your first schedule, Mr. Claypoole, you have a 90-day letter total figure of \$91,728.12. Do you mean by the \$74,984.96 that that is the figure that was used on Schedule Q in the Revenue Agent's report?

(Testimony of Paris B. Claypoole.)

A. That was used in Exhibit Q, as the amount distributable from the year 4/30/47. There has been added to that, however, in the calendar year reports on the individuals a sum which was determined from a subsequent fiscal year of the corporation.

Q. What subsequent fiscal year?

A. 4/30/1948.

* * * * *

Q. (By Mr. T. Baird): Mr. Claypoole, looking at Exhibit 16, your schedule entitled Comparative Analysis of Surplus for Year Ended April 30, 1947, you have near the bottom of the page Dividend Per 90-Day Letters. Did you mean dividends per RAR? A. No, sir.

Q. At that point?

A. I meant per Revenue Agent's report and not the 90-day letter.

Q. And did you also mean at the bottom of the page that the last item Dividend Per RAR instead of 90-day letter of \$74,984.96? [50]

A. Yes, sir.

Q. I just wanted to clear the record on that.

Mr. Claypoole, will you look at Schedule Q——

Mr. T. Baird: At this time, before we look at Schedule Q, I would like to offer in evidence as Petitioners' Exhibit 16——

Mr. Machtinger: No objection, your Honor.

The Court: Very well.

The Clerk: Petitioners' Exhibit 16 admitted in evidence.

(Testimony of Paris B. Claypoole.)

(Petitioners' Exhibit No. 16 was received in evidence.)

Q. (By Mr. T. Baird): Mr. Claypoole, referring again to Schedule Q of the Revenue Agent's report, I see here a column entitled E, Total Distributions Per RAR, a total amount of \$74,984.96. Then I see a breakdown under Gene Clark for the years 1946 and 1947. Will you, for the record, state what the amount shows available for distribution per Revenue Agent's report for the year 1946?

A. \$44,227.13.

Q. And will you also show the amount available for distribution in 1947?

A. \$8,262.34.

Q. Mr. Claypoole, from your analysis of this report, [51] have you been able to ascertain how these figures were arrived at for each of the two years? A. No, sir.

Q. Mr. Claypoole, you are apprized are you not, that the fiscal year, first fiscal year of the corporation, ended on April 30, 1947, is that true?

A. That is correct.

* * * * *

Q. (By Mr. T. Baird): I will ask you a hypothetical question, Mr. Claypoole. If a corporation started doing business on May 1, 1946 and had a fiscal year ending April 30, 1947, accumulated assets, let us say a great amount of which was cash from cash sales [52] and supposing that the officers of this hypothetical corporation were on a calendar year basis. Could those officers of this

(Testimony of Paris B. Claypoole.)

hypothetical corporation have received, in your opinion as an accountant, any dividends in the year, calendar year 1946?

A. That is qualified to this extent, that first, the profits are not determined until the close of the corporation's fiscal year and no amount available could be determined until the year's close or at the close of the fiscal year.

Q. What is one of the major factors to take into consideration of what is available for distribution at the close of any fiscal year of any given corporation, Mr. Claypoole?

A. The profits of the corporation.

Q. What liabilities in particular?

A. Well, of course, the principal liability is that of income taxes and, in California, State franchise taxes.

Q. Is it your opinion that in this hypothetical case that I have just presented to you that a dividend could not be distributed to the shareholders who were on a calendar year basis for the year 1946 when the fiscal year of the corporation ended April 30, 1947?

A. I would say that none could be determined as available for distribution in the calendar year 1946.

The Court: You mean that no matter what the interim figures were there could be no dividend?

The Witness: There could be a dividend, but when it is determined to be available. No one

(Testimony of Paris B. Claypoole.)

would know until the close of the fiscal year what if anything were available.

The Court: It is your opinion that that is necessarily so in all cases?

The Witness: Yes, sir.

The Court: All right.

Q. (By Mr. T. Baird): Even in cases where there is a great amount of cash that could have been available?

A. An operating company would of necessity have to determine its profits for the year before it could determine whether there was anything available and until the close of the fiscal year it would be impossible to determine what would be available because there may have been substantial losses which may have wiped out prior profits that were earned in a prior period, in the calendar year.

The Court: Wouldn't that apply to every second of a corporation's existence except the split second at the end of the fiscal year because two days later they might lose something the next year?

The Witness: Well, the end of the year, I believe that a sum could be determined that would be available.

The Court: At that time?

The Witness: At that time, yes, sir. [54]

The Court: But a week later, it might not be available?

The Witness: That is true, sir.

The Court: All right, go ahead.

(Testimony of Paris B. Claypoole.)

Q. (By Mr. T. Baird): May I add for the record that this hypothetical corporation had a zero surplus when they started, when they were organized as a corporation, and if I put that into the record, would you answer the same way, Mr. Claypoole? A. Yes, sir.

Q. Would you be more apt to answer that way—could a corporation have a surplus when they start out, when they organize, in an accounting sense?

A. Not an earned surplus. They might have a paid-in surplus.

Q. That is what I mean, an earned surplus.
* * * * * [55]

Mr. T. Baird: I offer this in evidence as Petitioners' next in order.

The Clerk: 17. Petitioners' Exhibit 17 admitted.

(Petitioners' Exhibit No. 17 was marked for identification and received in evidence.)

Q. (By Mr. T. Baird): I now show you, Mr. Claypoole, a schedule marked "Gene Clark, Inc., Disposition of Income Reported in Return, Fiscal Year April 30, 1947." Did you prepare this schedule, Mr. Claypoole? A. Yes, sir.

Q. What does it purport to cover? What is included in it?

A. It shows the disposition of the income or all receipts and disbursements from the day the corporation was started on May 1, 1946 to April 30, 1947.

(Testimony of Paris B. Claypoole.)

Q. Is it, in effect, an explanation or clarification of the debits and credits in the balance sheet, Mr. Claypoole? A. That is correct.

Q. And what is this Surplus Account you have marked at [56] the bottom of the schedule, Mr. Claypoole?

A. That is a reconciliation between the \$30,-632.10 reported in the tax return and the surplus as set forth in the closing balance sheet of \$21,-897.09. That is in there because the Reserve for Income Tax, \$8,735.01, is not a profit and loss adjustment. That is a surplus charge.

Q. And where in this schedule would the \$21,-897 that you have marked here as surplus, I believe, .09, where would that fall in your schedule here?

A. Well, that's the remainder between the debits and the credits, between the opening and closing balance sheets and the reserve for income tax of \$8,735.01.

Q. What I am getting at, would that have been taken up in the items that you have marked on this schedule Income Reported in Return?

A. Yes, sir.

Q. And will you list those items, please, that you have marked?

A. Do you want me to read?

Q. I just want you to read them for the record, not the amounts.

A. Purchase of real estate; purchase of trucks

(Testimony of Paris B. Claypoole.)

and equipment; improvements to buildings and leasehold; purchase of office equipment; notes receivable from officers; note paid off; accrued taxes, insurance, wages, et cetera; increase of cash on [57] hand.

Now, offsetting that are a decrease in accounts receivable, a decrease in inventory, a decrease in deferred charges, acquisition of trust deed, which is a liability; an increase in accounts payable, deferred income as a liability, reserve for depreciation——

Mr. Machtinger: If your Honor please, the record speaks for itself. I don't see the necessity of going through and listing all these debits and credits.

The Court: I'd like to ask this witness one hypothetical question, though, before we get too far away from his recent opinion.

Assume that a corporation was formed on January 1st, 1954 and that on December 31st, 1954 it had net earnings after taxes of \$100,000, and assume that on July 1st, 1954 it had distributed to its stockholders \$50,000. Would you say that that \$50,000 was or was not an ordinary dividend from the income tax standpoint?

The Witness: I would say it was an ordinary dividend.

The Court: All right, thank you. Go ahead.

Mr. T. Baird: I see that I forgot to have this marked for identification. I would like to have it

(Testimony of Paris B. Claypoole.)

marked for identification and at the same time offer it as petitioners' next in order.

The Clerk: Exhibit 18. [58]

* * * * *

Cross Examination

Q. (By Mr. Machtinger): Mr. Claypoole, have you examined all the books and records of the corporation? A. No, sir.

Q. Have you recomputed or attempted to recompute the net income of the corporation or have you made all your schedules from the Revenue Agent's report and the income tax returns of the individuals, as well as of the corporation?

A. They have all been made from those reports.

Q. Referring to Petitioners' Exhibit 15, your first item is Income Per Tax Return of \$30,632.10, to which you add \$102,050.17, representing adjustments to the taxable income per the agent's report. You then arrive at \$132,682.27. First, Mr. Claypoole, would you say that the income tax per return of [59] \$30,632.10 is income which should be considered in order to arrive at what is available for distribution? A. It should be considered.

Q. Why do you deduct it from the \$132,682.27 in coming to a figure of what is available for distribution?

A. Because it had been used by the corporation for purposes other than distribution.

Q. But if you are arriving at a total income of the corporation, don't you take into account the full income of the corporation before you make any

(Testimony of Paris B. Claypoole.)

deductions from that income to arrive at income available for distribution? A. Yes, sir.

Q. Have you prepared a schedule showing in what manner that \$30,632.10 was used so that it was not available for distribution?

A. That is reflected in the balance sheet of the corporation, balance sheet with the return.

The Court: What was this use, Mr. Claypoole? Let's not keep it a mystery.

The Witness: It was used for the purchase of machinery, trucks, real estate, paying off note, paying various bills, reserve for depreciation, taxes, for all the corporate uses of that nature.

Q. (By Mr. Machtinger): So that your deductions go back to what is contained [60] in the balance sheet as attached to the income tax return of the corporation, is that correct? A. Yes, sir.

The Court: Is it your idea that because funds are not in cash they can't be distributed?

The Witness: No, sir.

The Court: Well, I must say that I don't follow you on the \$30,000-odd-dollar item. If you have any more explanation, I'd be glad to have it.

The Witness: Well, in this computation that was made in the Revenue Agent's report, he arrived at a theoretical amount available for distribution. Now, that is something after the corporation has actually used funds for specific purposes and the remainder then represents an amount that he sets up as available for distribution.

The Court: Do I understand you to mean that

(Testimony of Paris B. Claypoole.)

if a corporation has an earned surplus of \$100,000 and has put it into equipment or anything of that sort that it is not available for distribution?

The Witness: It is not available in a physical sense. The assets could be distributed, a building could be distributed.

The Court: You could go down to the bank and borrow something and distribute, too, couldn't you?

The Witness: Yes, sir.

The Court: All right, go ahead. [61]

Q. (By Mr. Machtinger): Mr. Claypoole, if the Gene Clark Corporation showed a surplus at the end of the fiscal year '47 and distributions were made to the stockholders during the calendar year 1946, would you say that there were no distributions to the stockholders during that calendar year that were taxable?

A. If the corporation showed a distribution, yes. If it showed a distribution, it would be reflected here.

Q. If the stockholders receive what might be termed constructive dividends, dividends that were not shown as such on the books of the corporation, and the corporation showed a surplus at the end of the year, would there not also be taxable dividends to the stockholders?

A. In certain circumstances. If the corporation shows that. In this case, I am working from actually what the record shows.

Q. What if the facts show that, Mr. Claypoole, hypothetically? Would you not agree that there

(Testimony of Paris B. Claypoole.)

were taxable dividends to the stockholders during the year, calendar year 1946?

A. To the extent of surplus available. If the facts disclosed that distributions had actually been made by the corporation.

Q. Since you have not examined all the books and records of the corporation, you are not then in a position to say whether or not there were any actual distributions to the [62] stockholders that were not reflected on the books and records, is that correct? A. That is correct.

Mr. Machtinger: That is all the questions we have.

Mr. T. Baird: No questions, your Honor.

The Court: All right, thank you, Mr. Claypoole.

Mr. T. Baird: If you wanted to ask a question, I will allow it. Just a minute, Mr. Claypoole.

Q. (By Mr. Machtinger): Mr. Claypoole, were the books and records of the corporation available to you?

A. I will have to qualify that. When I came into the case, they were subpoenaed in a court case and for weeks were across the street in the courthouse. They were not, at no time did I have an opportunity to make the kind of an investigation of the books that would qualify me to say that I have examined the books.

Q. Did you make a demand, you or your counsel make a demand for those books on the persons who had the books and records of the corporation?

A. Yes. Well, I didn't put it in any form of

(Testimony of Paris B. Claypoole.)

demand, but I asked to see the books. They were busily engaged with those records at that time and then about that period they were taken into this case in the State court and they were not available until about the latter part of this past week. [63]

Q. Did you ever make a demand for any books and records which was denied?

A. I didn't make a demand. I am just the——

The Court: Mr. Machtinger, he said he didn't examine them in any real sense.

Mr. Machtinger: No more questions, your Honor.

The Court: All right, Mr. Claypoole, thank you.

(Witness excused.)

Mr. T. Baird: Your Honor, the petitioner rests.

The Court: All right.

Mr. Machtinger: If the Court please, I would like to make a motion for judgment as set forth in the notice of deficiency in this case on the grounds that petitioners have failed to bear their burden of proof that the Commissioner erred in his 90-day letters.

The Court: What is the situation with respect to limitations for the years 1946, '47, '48, and '49?

Mr. Machtinger: With respect to the year 1946, the year is closed unless respondent proves fraud. With respect to the year 1947, please correct me if I am wrong, the year is closed unless respondent proves fraud or that there was an understatement of income by the petitioner of more than 25 per cent. There is no limitation question with respect to the years 1948 and 1949.

The Court: The motion is denied with respect to the [64] years 1946 and 1947 and is held under advisement as to the years 1948 and 1949 until the matter is considered on the merits.

Mr. Machtinger: Thank you, sir.

Mr. T. Baird: I won't cite my cases now, your Honor.

The Court: Go ahead.

Mr. Gardner: If the Court please, at this time respondent would like to waive the fraud as to Mrs. Clark for the years '46 and '47 at which time she filed individual tax returns.

The Court: Very well.

* * * * *

Y. L. CREED

was called as a witness by and on behalf of the respondent, and, having been first duly sworn, was examined and testified as follows:

Direct Examination

The Clerk: State your name and address, please.

The Witness: Y. L. Creed, C-r-e-e-d, 101 Andrea [65] Lane, Arcadia.

Q. (By Mr. Gardner): Mr. Creed, would you state your business? A. General contractor.

Q. Referring specifically to the year 1946, what business were you in?

A. I was a contractor.

Q. Would you state whether or not you had any business connections or any contracts with Gene Clark, Inc.? A. Yes, I did.

(Testimony of Y. L. Creed.)

Q. Would you state what business you had with the Gene Clark Plumbing?

A. Well, he plumbed four houses for me, I believe it was.

Q. Do you have the addresses on those houses?

A. Yes, I do.

Q. Would you state that?

A. Well, first one was 5965 Otis Avenue in Huntington Park and 5961 Otis Avenue and 5957 Otis Avenue, all in Huntington Park, and one at 4355 East 56th Street in Maywood.

Q. And what amounts, if any, did you pay to Mr. Clark?

Mr. T. Baird: Define your question.

Q. (By Mr. Gardner): What amounts, if any, did you pay to the Gene Clark, Inc., for the work performed?

Mr. T. Baird: If your Honor please, before the [66] witness answers, may I inquire as to what period of time you are interrogating the witness?

Mr. Gardner: I should have cleared that up, your Honor.

The Court: All right, go ahead.

Q. (By Mr. Gardner): At what time was the work done on these houses, Mr. Creed?

A. Between January and May, I think.

Q. Of what year, Mr. Creed? A. '46.

Q. January and May of '46? A. Yes.

Q. Do you know whether or not you were dealing with a corporation or with a partnership, Mr. Creed?

(Testimony of Y. L. Creed.)

A. Well, I didn't particularly know, I didn't inquire into it, no.

Q. The contract was made some time around February of '46, is that correct?

A. Well, I think they was made at different times. All I can refer to is the date I took out the permits, and the first one was taken out in December, December 26 of '45, and we started on it a week or so later, which is after the first of the year. And the next one was taken out January 11 in '46, and the next one January 15th in '46, and the last one was in [67] March, 22nd, in '46.

Q. Do your records reveal how you paid the amounts, if any, to the Gene Clark Plumbing?

A. Well, I am not clear on it, but I sold Mr. Clark one of those houses and he paid me a down payment on it outside of escrow and the rest of it evidently was straightened up in escrow because it it all marked paid here the same day, which is June 13th, 1946, and we straightened up after it went into escrow with the house, and I suppose that is the day I marked them all paid.

Q. Mr. Creed, I hand you a document signed by you on the 10th day of February, 1953 in an effort to refresh your recollection.

A. That seems to be correct, sir.

Q. Do you now recall how the——

Mr. A. Baird: May I see that, Mr. Gardner?

Mr. Gardner: Yes, sure.

In the interest of saving time, is there any objection to introducing this?

(Testimony of Y. L. Creed.)

Mr. A. Baird: If your Honor will bear with us just a moment. We will stipulate that the amounts are correct but not as to certain dates in there.

Mr. Gardner: As to being a payment out of escrow and this amount, is that correct that we have?

Mr. A. Baird: The amounts appearing on this document [68] are substantially correct, your Honor. We are not sure that they are absolutely accurate but sufficiently so for the purpose of this case. I am not certain of the dates.

Mr. Gardner: Would you mark this respondent's exhibit next in order?

The Clerk: Respondent's Exhibit O.

The Court: It is marked at this point for identification, I assume?

Mr. Gardner: I am going to put it into evidence, your Honor. There is no objection.

Mr. A. Baird: We would object to the affidavit itself, but I thought we could save time if we agreed with you about the amounts.

Mr. Gardner: You would object to the affidavit?

Mr. A. Baird: Yes.

Mr. Gardner: It is stipulated that the amounts paid by Mr. Creed on the four houses mentioned before in the testimony are \$680, \$680, \$742.50, and \$820, for a total of \$2,922.50.

(Respondent's Exhibit O was marked for identification.)

Q. (By Mr. Gardner): Now, Mr. Creed, would you state how that amount was paid?

(Testimony of Y. L. Creed.)

A. Well, to the best of my recollection, we straightened it up in escrow when we went through the escrow, and that is all [69] I remember about it and that's the reason I think every one of them is marked paid the same day. That evidently is when it was straightened up. I marked them all paid.

Q. Did you pay some of it by a personal check, Mr. Creed?

A. Yes, I paid the first payment I paid by a check which I have here.

Q. Would you give us the date of that?

A. That is the only check that I gave him, \$544.

Q. And the date on there is?

A. February 5th, '46.

Mr. Gardner: Would you mark this as respondent's exhibit next in order?

The Clerk: Respondent's Exhibit P.

Mr. A. Baird: No objection.

(Respondent's Exhibit P was marked for identification and received in evidence.)

The Court: Is this paper in evidence in whole or in part yet?

Mr. Gardner: Not yet, your Honor, just what I have read. He is merely using this to refresh his recollection.

The Court: All right.

Q. (By Mr. Gardner): You stated, I believe, that Gene Clark purchased a home or purchased a house from you. Was the remainder of the [70] balance which you owed to him, was that taken care

(Testimony of Y. L. Creed.)

of in this house or did you reduce the price on the house?

A. No, no, I sold the house to him for \$8,500 and when we went into escrow, why, he gave me credit for this amount.

Q. Did that appear in the escrow?

A. I imagine it did, I don't remember.

Q. Would you refer to your——

A. Well, I don't have my book on it. All I kept, just the cost sheet on the thing.

Q. But it was deducted from the price of the house? A. As I recollect, yes.

Q. The balance of \$2,378.50 was deducted, Mr. Creed?

A. That is the total of these jobs.

Q. That is the total of the jobs less the \$544 check?

A. Well, as I say, it's been nine years ago and the best of my recollection was yes.

Q. All of the remaining, in other words, was taken care of? A. Through the escrow.

Q. In reducing the cost of the house to Mr. Clark, is that correct? A. That's right.

Q. Thank you, Mr. Creed.

Is that your signature, Mr. Creed?

A. Yes, it is. [71]

Q. Did you make that statement of your own free will? A. What did you say?

Q. Did you make that statement of your own free will? A. Yes.

Mr. Gardner: At this time respondent moves to offer this into evidence.

Mr. A. Baird: Well, if your Honor please, I think it's been covered by the witness. This is an affidavit given by him in connection with this investigation to Special Agent Coons. It is self-serving in nature and we object to it for that reason.

The Court: May I see it, please?

I thought you took the position, Mr. Baird, that you objected only to the affidavit part or the date part of it.

Mr. A. Baird: No, I stated that I was not certain as to the dates contained in that document as to when certain payments were made. We are not making any complaints about the amounts. I don't think it is a matter of any great consequence to us one way or the other so far as that is concerned.

The Court: Neither do I, but if it is not admitted into evidence, then we may have to go back over the question of these dates. The check, as I understand it, is in evidence for \$544, is it?

Mr. Gardner: Yes, your Honor.

The Court: That has a date on it, no doubt. [72]

Mr. A. Baird: May I say, your Honor, that we will withdraw our objection if we may reserve the right to make such further check as might be necessary.

The Court: Well, I am satisfied to let it in subject to check and rebuttal testimony.

Mr. A. Baird: We will withdraw our objection, then.

The Court: It will be received.

(Respondent's Exhibit O was received in evidence.) [73]

* * * * *

TRUMAN JOHNSON

was called as a witness by and on behalf of the respondent, and, having been first duly sworn, was examined and testified as follows:

Direct Examination

The Clerk: State your name and address, please.

The Witness: Truman Johnson, 213 West Garvey Boulevard, West Covina.

Q. (By Mr. Gardner): Would you state your business, Mr. Johnson?

A. I am a general contractor, among other things.

Q. Referring specifically to the year 1946, on or about November of that year, did you at that time—would you state whether or not you had any business dealings with Mr. Gene [75] Clark?

A. I did.

Q. What was the business dealings that you had, Mr. Johnson?

A. I was building some houses in West Covina, and he did some plumbing jobs for me.

Q. Will you state whether or not you sold a house to Gene Clark? A. I did.

Q. Would you state the terms under which that house was sold?

A. I believe the price was \$22,000, if I recollect, and he paid me cash for part of it and did some plumbing jobs for the balance.

(Testimony of Truman Johnson.)

Mr. Gardner: Would you mark this for identification?

The Clerk: Respondent's Exhibit Q marked for identification.

(Respondent's Exhibit Q was marked for identification.)

Mr. Gardner: Would you mark this for identification, please?

The Clerk: Respondent's Exhibit R marked for identification.

(Respondent's Exhibit R was marked for identification.) [76]

Q. (By Mr. Gardner): Mr. Johnson, I hand you Respondent's Exhibit Q and ask you what that is.

A. This is a contract that Gene Clark Plumbing Company entered into with me for the plumbing of some houses in West Covina.

Q. What is the price shown on there, the estimated price? A. \$930.

Q. I hand you Exhibit R and ask you what that is.

A. This is a contract for plumbing 10 houses.

Q. And what is the total amount of that contract? A. \$3,300.

Q. Is this the contract that was given to you, Mr. Johnson?

A. I believe so, it looks like it.

Q. What was the usual cost per unit, Mr. Johnson, at that time for houses?

A. Well, I paid him \$930 for some and——

(Testimony of Truman Johnson.)

Mr. A. Baird: I object to that answer as not being responsive to the question. The question was what was the usual price. The witness answered, "I paid him." I move that it be stricken, the part that he answered.

The Court: I don't know what the usual price has to do with this, but I will be glad to hear from you, Mr. Gardner. [77]

Mr. Gardner: I will withdraw the question, your Honor.

Q. (By Mr. Gardner): I believe you stated that Mr. Clark, or Gene Clark, Inc. did some plumbing work for you on certain houses on Glendora Avenue, is that correct, Mr. Johnson?

A. Glendora Avenue, yes, sir, that is correct, and Barbara Avenue.

Q. Referring to those specific houses, what was the price which you expected to pay for the plumbing in those houses per unit?

A. I don't know how to answer that question. The contract there states the prices I paid.

Q. Were those prices low, Mr. Johnson?

A. \$3,300 was.

Q. What would you ordinarily pay for those houses?

A. Well, previously I paid him \$930 for some.

Mr. T. Baird: I move to strike that answer, it is not responsive to what would you ordinarily pay. If you want to restrict the question, what did you pay Mr. Clark before——

(Testimony of Truman Johnson.)

Mr. Gardner: I will carry on the cross, Mr. Baird, if you don't mind.

The Court: What was the fair price at the time, if you know?

The Witness: Well, that's a little difficult to [78] answer, what the fair price was.

The Court: Were there any special circumstances about this contract at which you got a special discount or cut rate, or weren't there?

The Witness: Part of the difference between those two sums was part payment for the house he bought from me.

Q. (By Mr. Gardner): And how much was that?

A. I assumed it was \$600 per contract.

Q. That is the contract for \$3,300 for the 10 houses was \$600 per unit less?

A. That's what I considered, yes, sir.

Q. And that was part consideration for the house which he purchased from you?

A. That is correct.

Q. Why was the deal handled in that manner?

A. Mr. Clark asked to have it handled that way.

Mr. Gardner: At this time I would like to introduce Respondent's Exhibits Q and R.

Mr. A. Baird: No objection.

The Clerk: Respondent's Q and R admitted in evidence.

(Respondent's Exhibits Q and R were received in evidence.)

Q. (By Mr. Gardner): How much was the total

(Testimony of Truman Johnson.)

amount of this, Mr. Johnson? [79] \$600, 10 houses, was it \$6,000? A. That would equal \$6,000.

Q. Did that \$6,000 appear in your escrow arrangement?

A. I am quite sure it did. On my books, I showed that I received \$22,000 for the house and I assume, I don't recall what the escrow statement said, but I am very sure that my books showed that I gave him credit for \$6,000 as part payment for the house, in connection with it.

Mr. Gardner: No further questions.

The Court: Your books reflected the full contract price.

The Witness: That is correct.

The Court: Which was in excess of the written contract price.

The Witness: My books showed that I received a benefit of \$6,000 from Mr. Clark.

Cross Examination

Q. (By Mr. T. Baird): Mr. Johnson, you stated on your direct examination that you sold this home to Gene Clark. I show you Respondent's Exhibit Q and R and ask you to read what it states. Does it state on a stamp on both Exhibits Q and R, Gene Clark, Inc.? A. It does so.

Q. 101 East Garvey, El Monte, California?

A. That's right. [80]

Q. Do you know whether or not you were dealing with Gene Clark, Inc. or Gene Clark as an individual?

(Testimony of Truman Johnson.)

A. It's nine years ago, I assume since that says Gene Clark, Inc. that I was dealing with Gene Clark, Inc.

Q. Thank you.

Mr. Gardner: We will stipulate that it was sold to Gene Clark, Inc., the corporation.

The Court: Well, is counsel willing to stipulate who or what entity took title?

Mr. T. Baird: Yes, your Honor, I will so enter into a stipulation that it was bought by Gene Clark, Inc.

The Court: And you agree with that, Mr. Gardner?

Mr. Gardner: Yes, I do, your Honor.

The Court: All right.

Q. (By Mr. T. Baird): Now, Mr. Johnson, the price of your home, \$22,000—you stated you are in the contracting business, did you not?

A. Yes, sir.

Q. You consider that price a little high for a home such as you sold to Gene Clark, Inc.?

A. No, it was a bargain at that price.

Q. We are interested in values here, Mr. Johnson, and I would like to know whether or not at this particular time, in 1946 I believe it was, you said,—

A. I didn't say when. [81]

Q. When was this transaction? When did it take place?

A. Well, I don't recall exactly, it could have been '46 or '47 for all my memory.

The Court: Doesn't it show on the contract?

(Testimony of Truman Johnson.)

Mr. T. Baird: Q is '46 and R is '47, your Honor.

The Court: All right, then it would be one each year. We will say 1946 and assume the transaction occurred then.

The Witness: Could have been.

Q. (By Mr. T. Baird): Do you think that you could have gotten plumbing per unit at \$600 per house? A. No.

Q. From any plumber in those days?

A. No.

Q. In 1946, I mean. A. No.

Q. You think you could have gotten it for \$600 per unit in 1947? A. No.

Q. Isn't it true, Mr. Johnson, that plumbing prices came down quite considerably between 1946 and 1947? A. I don't believe so.

Q. Did they remain constant or did they go up?

A. They were at their peak along at that time.

Q. Along at what time?

A. Along in '47.

Q. Were they also at their peak in '46?

A. They were going up in '46.

Q. You stated that Mr. Clark asked to have it handled that way. Did you not feel that this was a beneficial way for it to be handled for yourself?

A. No.

Q. And it was not you that requested it?

A. I didn't request it. As a matter of fact, I objected to it.

Mr. T. Baird: No further questions.

Mr. Gardner: No redirect. [83]

* * * * *

BEN LANG

was called as a witness by and on behalf of the respondent, and, having been first duly sworn, was examined and testified as follows:

Direct Examination

The Clerk: State your name and address, please.

The Witness: Ben Lang, 4060 East 54th Street, Maywood, California.

Q. (By Mr. Gardner): Mr. Lang, what is your business? A. I am an owner-builder.

Q. Referring to the year 1948, what was your occupation? A. Owner-builder.

Q. Will you state whether or not you had any business dealings with Gene Clark?

A. I have.

Q. Referring specifically to the date on or about April 21st, 1948, did you have any business dealings with Mr. Clark?

A. Thinking back that far, without some records, I wouldn't want to say.

On April 20, 1948, that check was signed by me, no doubt.

Mr. Gardner: Please mark the check as Respondent's exhibit next in order.

The Clerk: Respondent's Exhibit S marked for identification. [84]

(Respondent's Exhibit S was marked for identification.)

The Clerk: Respondent's Exhibit T marked for identification.

(Testimony of Ben Lang.)

(Respondent's Exhibit T was marked for identification.)

Mr. A. Baird: We will stipulate. Are these marked?

Mr. Gardner: These are marked for identification, S and T.

Mr. A. Baird: We are willing to stipulate that the witness, Ben Lang, paid Gene Clark, Inc.—well, I am not sure. The invoice is Gene Clark, Inc. and the check is made to Gene Clark, so I don't know.

The Court: Why can't we stipulate that the invoice is Gene Clark, Inc. and that the check is Gene Clark and let it in evidence so we can see what the endorsement shows?

Mr. A. Baird: There is no objection to that. That endorsement on the back is Gene Clark.

The Court: What we are trying to get at are the facts.

Mr. A. Baird: No objection to the documents being offered.

The Court: Very well.

Mr. Gardner: Will you further stipulate that this is in payment for plumbing work? [85]

Mr. A. Baird: Yes, we will.

Mr. Gardner: And that the check was issued in response to the invoice, Exhibit T.

Mr. A. Baird: Yes, we will so stipulate. What does the endorsement on the check show, Mr. Gardner?

Mr. Gardner: The endorsement shows Gene Clark.

(Testimony of Ben Lang.)

The Court: I understand these came in without objection.

The Clerk: Respondent's Exhibits S and T admitted.

(Respondent's Exhibits S and T were received in evidence.)

Q. (By Mr. Gardner): Was there any particular reason, Mr. Lang, why this check was made to Gene Clark personally, do you recall?

A. I don't recall of any particular reason.

Mr. Gardner: No other questions.

Mr. A. Baird: No questions. [86]

* * * * *

FRANCES B. BITTINGER

was called as a witness by and on behalf of the respondent, and, having been first duly sworn, was examined and testified as follows:

Direct Examination

The Clerk: State your name and address, please.

The Witness: Frances B. Bittinger, 608 Leonard Street, Montebello.

Q. (By Mr. Gardner): Mrs. Bittinger, what is your occupation?

A. At the present time, I am secretary and treasurer of the Hamilton Sales Corporation.

Q. Referring specifically to the year 1947, what was your occupation?

A. 1947, I was assistant secretary and treasurer of Hamilton Homes, Inc. as well as Hamilton Sales Corporation.

(Testimony of Frances B. Bittinger.)

Q. What were your duties, Mrs. Bittinger?

A. Well, I was assistant bookkeeper and office manager.

Q. Did you issue any checks? A. Oh, yes.

Q. Was that part of your job?

A. That was part of my job, yes, sir, all checks, everything, all bills came over my desk.

Q. You prepared certain other records to show why the checks were disbursed? [87]

A. Yes, I did.

Q. What was the basis for the issuance of checks?

A. Well, the bills on the Hamilton Homes, Inc. came into my desk approved by the building superintendent for payment, and I would check it against the contract and if it was in balance or warranted payment, why, the checks were issued.

Mr. A. Baird: These may all be offered as far as we are concerned.

Mr. Gardner: Will it also be stipulated that these checks were issued in payment for the invoices as shown?

Mr. A. Baird: Well, I think the invoices speak for themselves. I prefer you ask the witness that.

Mr. Gardner: All right.

Would you mark this as respondent's next in order.

The Clerk: Respondent's Exhibit U marked for identification.

The Court: There is no need to mark them for identification. Counsel has stated that he has no

(Testimony of Frances B. Bittinger.)

objection to their coming in. They can come in and then Mr. Gardner can still ask the witness such questions as he may care to in explanation.

The Clerk: Exhibit U admitted in evidence. Respondent's Exhibit V admitted in evidence. Respondent's Exhibit W admitted in evidence.

(Respondent's Exhibits U, V, and W were marked for identification and received in evidence.) [88]

Q. (By Mr. Gardner): Mrs. Bittinger, I hand you Exhibit U and ask if you have seen that before and, if so, what is it?

A. I have, this is an invoice and a check and we at one time used a voucher system of proving the payment of this particular job here. This invoice covers the finish only for some tract houses that we were building on Bleakwood Avenue.

Q. The check was issued in payment of the invoice, is that correct?

A. That's right, yes, it is.

Q. I hand you Government Exhibit V and ask you to explain that exhibit, if you know.

A. This, likewise, is an invoice, check, and a voucher for billing issued to us on July 9, 1947. It covers 60 houses, tract houses, covering houses built on tracts 13296 and 13297 and 13584. That is for rough-in plumbing.

Q. And the check was issued in payment?

A. That's right.

Q. Of the invoice?

A. That's correct.

(Testimony of Frances B. Bittinger.)

Q. I hand you Exhibit W and ask you what that is.

A. This check is for \$2,295, dated September 16, 1947, to Gene Clark, Inc. and covers 17 panel rays installed on our tract houses on Bleakwood Avenue.

Mr. Gardner: No further questions. [89]

Mr. A. Baird: We have no questions.

The Court: All right, thank you.

(Witness excused.) [90]

* * * * *

[Endorsed]: Filed April 18, 1955.

[Title of Tax Court and Docket Nos. 48542-3-4.]

Los Angeles, March 31, 1955

9:30 o'clock a.m.

PROCEEDINGS

* * * * *

LLOYD GEORGE MEISSENBURG

was called as a witness by and on behalf of the respondent, and, having been first duly sworn, was examined and testified as follows:

Direct Examination

The Clerk: State your name and address, please.

The Witness: Lloyd George Meissenburg, M-e-i-s-s-e-n-b-u-r-g, 3924 North Charlotte, Rosemead.

Q. (By Mr. Gardner): Mr. Meissenburg, what is your occupation?

(Testimony of Lloyd George Meissenburg.)

A. Plumbing contractor.

Q. Referring to the year 1948, what was your occupation at that time?

A. Same, plumbing contractor.

Q. Did you ever purchase any plumbing supplies from Gene Clark, Inc.? A. I did.

Q. How did you pay for those supplies?

A. By check and by cash. [102]

Q. Do you have the checks with you, Mr. Meissenburg? A. Yes, I do.

* * * * *

Q. Was any other payment made by you to Mr. Clark or to the Gene Clark, Inc. in addition to the two checks that have been recently marked for identification?

A. Yes, I gave him \$12,000 in currency.

The Court: Who did you turn it over to physically?

The Witness: Gene Clark.

Q. (By Mr. Gardner): Where did you get the currency that you paid to Mr. Clark?

A. From the First State Bank of Rosemead and Bank of America in El Monte.

Q. Was there any particular reason that you used cash for this transaction, Mr. Meissenburg?

A. Not that I recall. [103]

* * * * *

Q. I hand you Respondent's Exhibit MM and ask you if that is the check which you used to pay Gene Clark? A. Yes, it is.

Q. To whom did you give that check?

(Testimony of Lloyd George Meissenburg.)

A. To Gene Clark.

Q. And what was it for?

A. Plumbing materials.

Q. I hand you Exhibit LL and ask you what that is.

A. That was a check for which I gave to Gene Clark for plumbing materials.

Q. Do you have the dates?

* * * * *

The Witness: This last check that the gentleman [104] handed me was for plumbing materials I purchased from Gene Clark.

Q. (By Mr. Gardner): On what date was the payment in cash made, Mr. Meissenburg?

A. March 2nd, 1948.

Q. I hand you Exhibit OO and ask if you have ever seen the original of that document?

A. Yes, I have.

Q. Would you state what it is?

A. It is materials I purchased from Gene Clark.

Q. I hand you Exhibit NN and ask if you have seen the original of that document.

A. Yes, I have.

Q. What is that?

A. For plumbing materials purchased from Gene Clark.

Q. Is that an itemized account of the plumbing materials which you purchased?

A. Yes, it is. [105]

* * * * *

Q. (By Mr. Gardner): Did I understand cor-

(Testimony of Lloyd George Meissenburg.)

rectly, Mr. Meissenburg, was the cash issued in payment for materials? A. Yes, it was.

Q. Were the checks issued in payment for materials? A. Yes.

Mr. Gardner: No further questions.

Cross Examination

Q. (By Mr. T. Baird): Mr. Meissenburg, do you know whether or not when you sold these materials you were dealing with Gene Clark, Inc. or Gene Clark Plumbing?

A. No, all I know, I was dealing with Gene Clark. I didn't know if it was incorporated or a company, just what it was.

Q. I show you Respondent's Exhibit MM, a check in the amount of \$22,935, bearing the date 2/9/48. Will you state for the record who that is payable to the order of? A. Gene Clark.

Q. And will you look at the back of the check and see who endorsed the check? Will you state that? A. Gene Clark.

Q. I now show you Respondent's Exhibit LL. That is a [106] check dated 1—

Mr. Gardner: If the Court please, we will stipulate that it was payable to Gene Clark and signed by Gene Clark. The document speaks for itself.

The Court: The checks are already in evidence. I don't know what this witness can add to them. Certainly, it is not necessary to point out the endorsements. I mean, you can ask him anything else you want, but that's already in the record.

(Testimony of Lloyd George Meissenburg.)

Mr. T. Baird: Thank you.

Q. (By Mr. T. Baird): You stated on direct examination that something happened on March 2nd, 1948. I didn't catch what happened.

A. That was when I gave Gene Clark \$12,000 cash.

Q. Mr. Meissenburg, I wonder if you could relate to the Court what the transaction, tell us a little bit about the transaction and how long a period it covered? In other words, what I am getting at, how many deliveries were made and whether this was one transaction or a series of transactions or just what the situation was.

A. Well, as I recall, there were several loads of material that we picked up from Gene Clark's yard and I believe it was divided between rough and finished material for which we made payments as we got certain amounts.

Q. Approximately what was the first date that you [107] picked up materials from the yard, do you know?

A. I don't recall.

Q. Was it before you made payment by check?

A. It was prior.

Q. Or after or about that time?

A. We picked the material up first and paid him for it after it was in our yard.

Q. And how many times did you pick material up in this series of transactions?

A. Well, there was quite a bit of material there. I would say there was about ten truckloads. Our truck has an 18-foot bed on it.

(Testimony of Lloyd George Meissenburg.)

Q. I mean, was it over a period of, say, a month?

A. I would say a month, yes, as I recall.

Q. And the later check, the check dated 2/9/48, would that check have been issued about the time that you picked up material or a little after?

A. A little after, yes.

Q. And would you have paid the cash to Gene Clark a little after, some time after a delivery that was previously made?

A. I would say yes because we did receive the material before we paid for it.

Q. Would you state who was present when these deliveries were made at the yard of Gene Clark?

A. Well, Gene Clark was present and whoever the men were that he had working for him, and I had one fellow working with me from my shop.

Q. Specifically, was Archie Koyl present at any of those deliveries?

A. No, I find that in recalling my business with Archie, I didn't know Archie until after I had bought this material from Gene Clark, when he took over the company.

Q. You mean to say that Archie Koyl was not present at any of the times these deliveries were made, he was not loading material on the truck?

A. No, he wasn't. I believe I talked to you about that.

Q. Yes, you did, and that is why I am surprised.

A. I didn't know him at the time. After recalling my relationship with Archie, it was after he

(Testimony of Lloyd George Meissenburg.)

bought out Gene Clark, whatever the circumstances were, and we bought material back and forth from each other at that time, and that's where those dealings came.

Q. All right, that is all.

The Court: Do you recall whose idea it was to pay the substantial amount in cash? I am just asking you whether you recall, I don't want you to guess at it.

The Witness: No.

The Court: You either recall or you don't.

The Witness: No, I really don't recall whether we [109] suggested it or whether Gene suggested it.

The Court: All right, any further questions?

Mr. T. Baird: I have one more question, your Honor, if I may.

Q. (By Mr. T. Baird): I will try to refresh your memory. I know it is pretty hard to go back all those years. Do you recall whether Mr. Archie Koyl was present at any time when material was delivered to your establishment?

A. No, I don't recall.

The Court: Well, which one of the two establishments was he dealing with? Which establishment of Gene Clark were you dealing with? He had two places, didn't he?

The Witness: Yes.

The Court: Which one were you dealing with?

The Witness: I was dealing with the one in El Monte.

Mr. T. Baird: That is all, your Honor.

(Testimony of Lloyd George Meissenburg.)

Mr. Gardner: Could I ask one or two more questions?

Redirect Examination

Q. (By Mr. Gardner): When you picked up the material, Mr. Meissenburg, would you state just where you got it? A. From El Monte.

Q. Was it Gene Clark Plumbing?

A. Pardon? [110]

The Court: He has made it clear that he picked it up at the Gene Clark Plumbing, Gene Clark plant.

The Witness: We didn't pick up any material from his other place.

Q. (By Mr. Gardner): Was this material you picked up separated in any way from the other material that was there?

A. We picked up all the rough material. There wasn't too much finished material, which consists of fixtures and such as that.

Q. Was it all together in the same yard?

A. Yes.

Q. Was there any separation there that you could tell, other than that separating rough and finished?

A. Well, he made some deliveries himself. I don't know where that came from.

Q. But speaking of the material you picked up——

A. I picked up everything from El Monte, yes.

Q. And this wasn't set apart in any way, was it? A. No.

Mr. Gardner: No further questions.

The Court: In order to pick up a loose end, would counsel be willing to inform me and the record as to whether or not Gene Clark Plumbing or any organization purporting to operate under that name filed a partnership return during any [111] of the years in question?

Mr. T. Baird: I will be willing to stipulate that they did not, your Honor.

The Court: You will be willing to stipulate the same?

Mr. Machtinger: Yes, sir, not only that there was not a partnership return filed, but to my knowledge no other return, an individual tax return by Gene Clark and a corporation return by the corporation.

The Court: Do you agree with that?

Mr. T. Baird: I do. [112]

* * * * *

FREDERICK W. FILES

was called as a witness by and on behalf of the respondent, and, having been first duly sworn, was examined and testified as follows:

Direct Examination

The Clerk: State your name and address, please.

The Witness: Frederick W. Files, F-i-l-e-s, 850 North Palm Avenue, Whittier, California. [122]

Q. (By Mr. Machtinger): Mr. Files, what is your occupation?

A. At the present time, I am employed by the

(Testimony of Frederick W. Files.)

Valley City Supply Company as a credit manager.

Q. How long have you been employed with that company? A. Since August of '49.

Q. Prior to your employment with that company, by whom were you employed?

A. By Gene Clark, Inc. and Gene Clark Plumbing.

Q. And when did you first start with Gene Clark, Inc. or Gene Clark Plumbing?

A. In August, I mean in February of '45.

Q. And what was your position with Gene Clark Plumbing or Gene Clark, Inc.? What were your duties?

A. I was the controller and the office manager.

Q. Were you the controller on or about the date of May 1, 1945? A. Yes.

Q. Do you recall that as being the approximate date when Gene Clark, Inc. was formed?

A. Yes.

Q. Under whose direction did you work as controller of the corporation?

A. Under the direction of the officers.

Q. Who were the officers?

A. Gene Clark was president, Archie Koyl was vice president, [123] and we had various secretaries.

Q. What were your duties as controller?

A. To handle the office end of the business, supervise the books, make the collections, take care of the odds and ends in connection with payrolls and all of the office work.

(Testimony of Frederick W. Files.)

Q. As controller, were you familiar with the manner in which the books were being prepared and being kept up and the manner with which——

A. Yes.

Q. Were you familiar with the manner in which the corporation handled its cash that it received from sales? A. Yes.

Q. Were you familiar with the manner in which the corporation handled its stock and inventory?

A. Yes.

Q. Were the preparation of the books and the care of the books left to your discretion or did you work under the direction of one of the—immediate direction of any of the officers?

A. Not so far as the books were concerned.

Q. Mr. Files——

Mr. A. Baird: Just a minute, may I get that answer clarified? You mean that you took care of the books and handled the books and directed what went into the books on your own initiative?

The Witness: No, I just handled the entries in the [124] books.

Q. (By Mr. Machtinger): To correct the record, I believe I asked you whether or not the corporation was incorporated as of May, 1945. Was it not '46?

A. Oh, yes, I believe you are right, sir. The seal says April 23rd, 1946.

Q. '46? A. That is what is on the seal.

Q. How many shops or places of business did

(Testimony of Frederick W. Files.)

the corporation have during the time you were employed with it? A. Two.

Q. Where were they located?

A. One at Five Points in El Monte, I believe the address was 10,100, and another one at 6833 Eastern Avenue in Bell Gardens.

Q. Did you work at both shops? A. Yes.

Q. Was there one set of books for both shops?

A. Yes.

Q. And one set of entries for sales and receipts for both shops? A. Yes.

Q. Did the corporation sell for cash at any time while you were with the corporation? [125]

A. Yes.

Q. And what type of transactions? Were these daily transactions through people that came to the shop? A. Yes.

Q. Did you handle the bank deposits of the cash? A. Yes.

Q. Could you explain to the Court your usual procedure in taking care of the cash received through daily transactions?

A. We maintained consecutively numbered duplicate receipt books in both shops. When cash was received on what we might call open account receivable, the entries were made when the checks or money came in in the receipt book, which was really a memorandum that was transferred later to the cash receipts journal in the books of account. We maintained the receipt book for two reasons. One was to give the customer a receipt if he wanted

(Testimony of Frederick W. Files.)

it, and the second one was to maintain a daily record in both shops that was accessible to the office girls or any of the supervisory help, so that when I came back to that at a later date there was a complete record of what went on while I was gone or before I put the entries in the books.

Cash sales were accumulated daily or perhaps several times a week, tapes were run on them, and a receipt was generally written for the total amount of a certain group of sales. The deposits were made and recorded generally weekly, and I would generally record my deposit in the receipt book, too, as a [126] memorandum record.

Q. Did you enter all of the sales, cash sales, at the shops as a record in the sales journal?

A. No, sir, they'd be grouped together as one lump sum entry.

Q. And did you enter the cash receipts in the cash receipts journal?

A. As one lump sum entry.

Q. Did you regularly deposit the cash that you received through your daily sales?

A. I regularly deposited all that was turned over to me for such purpose.

Q. Who would turn over the cash to you?

A. Mr. Clark.

Q. How would he get the cash? Was he the officer who was making the sales over other people in the shop?

A. Other people were making sales, too.

(Testimony of Frederick W. Files.)

Q. And what was done with the cash that other people received?

A. Brought into the office and put in the cash box along with a ticket.

Q. How would Mr. Clark obtain the cash?

A. By just taking it.

Q. And did he turn over to you the total amount received each day for deposit in the bank account?

A. I am not certain, I don't know. He turned over to me all that I reported.

Q. Well, is there a difference between the amount you recorded and the amount of cash sales that were made by the corporation?

A. There was.

Q. And what represented that difference?

A. Amounts that would have been withheld and not turned over to me for deposit.

Q. The amounts that were withheld, were they amounts realized from sales of corporate supplies or inventory?

A. Sales of supplies and inventory in our yard, yes, sir.

Q. With respect to those amounts that were withheld, was any record made in the corporate books and records of the sales of those items?

A. No.

Q. To the extent that the amounts — that cash was withheld, were you not, as controller, concerned with getting a correct figure of receipts of the corporation so that the correct income could be computed?

A. Yes.

(Testimony of Frederick W. Files.)

Q. Did you feel that your records—was it your opinion that the records did correctly reflect the total sales and income of the corporation?

A. They reflected what was turned over to me to enter [128] into the books, yes.

Q. Well, did they reflect the total amounts of sales of the corporation? A. No.

Q. Was it not your responsibility to see to it that the corporation books and records did reflect the total amounts of sales?

A. It was my responsibility to ask about it, which I did.

Q. Of whom did you ask? A. Mr. Clark.

Q. When you say you asked Mr. Clark, what is it that you asked Mr. Clark?

A. Well, I remonstrated that we might be open to criticism for such action, and Mr. Clark told me that he'd handle his end of the business and I'd handle mine.

Q. Did the same practice go on at both shops of the corporation or only at the El Monte Shop, which I understand Mr. Clark managed?

A. The Bell Gardens shop, when I would pick up and record cash sales at the Bell Gardens shop, I would simply record what was left there for me to record. I have no knowledge of just exactly how, if there were, differences.

Q. You do have knowledge that there were differences in the El Monte shop? [129]

A. Correct.

Q. In the course of your work with the Gene

(Testimony of Frederick W. Files.)

Clark Corporation, do you have any knowledge as to whether at any time supplies or inventories were removed from the stock of the corporation which were not reflected on the books and records of the corporation? A. Yes.

Q. And would you explain to the Court under what circumstances that occurred?

A. Well, I would see material leaving the premises on which there would be no corresponding compensation made on the books of the corporation for such shipments.

Mr. T. Baird: Excuse me, counsel, could we have dates?

Mr. Machtinger: I will get into dates, yes.

Mr. T. Baird: Thank you.

Q. (By Mr. Machtinger): You stated you were employed with the corporation at the time that it incorporated on or about May 1, 1946?

A. Yes.

Q. Can you state whether or not you recall as to whether any cash was turned over to Mr. Clark which was not reflected on the books and records of the corporation during the balance of the calendar year 1946? In other words, between May and December 31st of 1946? [130]

A. Well, our procedure wasn't changed any. The procedure of cash sales, I might say, was not changed any after incorporation.

Q. And during the year 1947, did the same practice continue? A. Yes.

Q. And during the portion of the year 1948 that

(Testimony of Frederick W. Files.)

Mr. Clark was with the corporation, did that practice continue? A. Yes.

Q. During the year 1948, Mr. Clark was with the corporation during the entire year, was he not?

A. Yes.

Q. It continued during the year 1948?

A. I beg pardon?

Q. And it continued during the year 1948?

A. Yes.

Q. Did it continue through the portion of the year 1949 which, I believe, was during all of January and perhaps a few days in February?

A. Yes.

Q. And with respect to the withdrawals of inventories in the form of plumbing supplies and other plumbing materials, during the balance of the calendar year 1946, between May and December, 1946, do you recall whether or not there was any removal of supplies which were not reflected in the corporate [131] books and records?

A. Only to the extent that it was a daily occurrence, you might say.

Q. Under whose direction were these supplies removed?

A. Mr. Clark's. Mr. Machtinger, when you say "removed," you mean sold?

Q. Do you know as a matter of fact whether those supplies were being removed for purpose of sale?

A. Those would be the only ones I would pay any attention to. I wouldn't pay any attention to a

(Testimony of Frederick W. Files.)

truck leaving the yard with material for a job or something like that.

Q. Was it not customary, the customary practice to record in the books and records of the corporation——

Mr. A. Baird: Mr. Machtinger, I haven't objected, but I don't think you should lead this witness.

Mr. Machtinger: All right.

Mr. A. Baird: I want to get along here as rapidly as we can.

The Court: I agree that they shouldn't be leading, but this witness isn't being either led or misled up to the moment. I think it is a rather consecutive picture and Mr. Machtinger seems to be trying to save a little time, but if you feel there is an element of being leading, then he will have to rephrase his questions. Very well. [132]

Q. (By Mr. Machtinger): What was the customary procedure that was followed with respect to the books and records of the corporation and in entry into those books and records of the corporation when there was a sale of materials from the supplies on hand?

A. Just a cash sale and not a contract sale, you mean?

Q. Yes.

A. The material would be delivered to the customer, a ticket would be written, and he would either give us currency or a check, and it would be put in the cash receipts box.

(Testimony of Frederick W. Files.)

Q. With respect to your testimony of materials going out for what you understood were sales and which were not reported to you, was the same procedure followed with respect to the books and records?

A. I don't follow that, sir.

Q. You testified, Mr. Files, that there were times when Mr. Clark either took or sold materials which left the yard and for which there was no entry in the books and records?

A. Correct.

Q. Now, were those, was it ever your understanding that those materials were going out as goods sold rather than on contract jobs?

A. Yes.

Q. And there were times when there were not entries in the books and records for those goods that were going out?

A. Yes. [133]

Q. And did that occur at any time to your recollection during the period May 1, 1946 to December 31, 1946?

A. I can't recall any specific shipment, but it was a regular occurrence.

Q. And during 1947, was it a regular occurrence?

A. Yes.

Q. During 1948?

A. Yes.

Q. And during 1949, to the best of your recollection, up to the time when Mr. Clark left the corporation?

A. Yes.

Q. Mr. Files, you were with the organization prior to May 1, 1946, were you not?

A. Yes.

Q. Could you strike that question, please?

Mr. Files, was there ever an occurrence when

(Testimony of Frederick W. Files.)

someone would bring a check to you and substitute it for cash proceeds that you had received during that date? A. Yes.

Q. Will you explain how that would occur?

A. Well, if I had cash available in the safe as proceeds of sales made for cash, Mr. Clark would have a check that he wanted me to cash, I'd cash it for him.

Q. Was that check which he would cash ever a check received in consideration for the sale of corporate goods? [134]

A. Not by me. In other words, I had no record of it.

Q. You had no record of it? A. Yes.

Q. Were those his personal checks, Mr. Files?

A. No, they would be third-party checks.

The Court: Do you know whether they were customer checks?

The Witness: They would be made out to Gene Clark, Inc.

The Court: Do you remember whether any substantial number of them were from makers that you knew to be customers of Gene Clark, Inc.?

The Witness: Yes.

Q. (By Mr. Machtinger): Did that practice occur, to your best recollection, during the calendar year 1946 between the dates of May and December of that year? A. Yes.

Q. And during the year 1947? A. Yes.

Q. And during the year 1948? A. Yes.

Q. And during the first month of 1949?

(Testimony of Frederick W. Files.)

A. Yes.

Q. Mr. Files, you were with the corporation, with the [135] organization before it incorporated, were you not?

A. Yes.

Q. Was the organization located in the same place before it incorporated as after it incorporated?

A. The same two places, yes, sir.

Q. After incorporation, did you keep one set of records for a corporation and any other set of records for any other organization?

A. Just kept one set of records for the corporation.

Q. Were materials segregated in the yards or was there one supply of materials which the corporation drew on?

A. There was no segregation to my knowledge.

Q. Were the workers in the yards who would load the trucks that went out employed by the corporation or by any other party?

A. By the corporation.

Q. Were the workers paid by the corporation?

A. By the corporation, yes, sir.

The Court: Mr. Machtinger, it may be that, with counsel's permission, I am going to want to ask a few questions along those lines myself when you get through and possibly prior to cross examination in order to give an opportunity for it. I would rather go into it as a whole. I think it is a good time to recess until five minutes after eleven.

(Short recess.) [136]

The Court: Go ahead.

(Testimony of Frederick W. Files.)

Q. (By Mr. Machtinger): Mr. Files, did you handle the books and records of the corporation or supervise the entry in the books and records prior to the date on which the organization incorporated?

A. Yes.

Q. At the time of incorporation, was the inventory that was on the books and records of the prior organization picked up as the organization inventory of the corporation?

A. I believe that there was some adjustment, I don't recall what. There was a fresh inventory for incorporation.

Q. Was it a detailed inventory, item by item inventory? A. Item by item inventory.

Q. Did you take it? A. No, sir.

Q. Who took it? A. Mr. Clark.

Q. He gave you a figure?

A. He gave me a figure.

Q. At any time during incorporation, was there an inventory taken of the supplies and stock and other items on hand? A. Yes.

Q. At that time, was there a separation made of what was purported to belong to the corporation and what was [137] purported to belong to any other entity?

A. Not given to me that way, no.

Q. To your knowledge, was the inventory as given to you, did it represent, to your knowledge, the entire inventory on hand? A. Yes, sir.

Q. Did that include the fiscal year of the corporation ending April 30, 1947? A. Yes, sir.

(Testimony of Frederick W. Files.)

Q. April 30, 1948? A. Yes, sir.

Q. And at the time when Mr. Clark withdrew from the organization, on or about February 4, 1949?

A. That inventory I took myself.

Q. And did that inventory that you took include everything that was in the yards and in the stock of the organization?

A. That inventory included everything.

Q. Do you recall, Mr. Files, the transaction between the organization and the Valley Boulevard Plumbing and Electric Company on or about January, during the months of either January or February, 1948?

A. I recall seeing their trucks and personnel removing material from the yard, yes, sir.

Q. Is that the organization with which, to your knowledge, [138] Mr. Meissenburg is associated?

A. Yes, sir.

Q. Did the workers or employees of the corporation load those trucks? A. Yes, sir.

Q. Were those workers paid by the corporation?

A. Yes, sir.

Q. I hand you what is identified as Respondent's Exhibits LL and MM, which are two checks from the Valley Boulevard Plumbing and Electric Company to Gene Clark. Do the books and records to your knowledge record in the sales journal a sale by the corporation to the Valley Boulevard Plumbing and Electric Company in these amounts?

A. No, sir.

(Testimony of Frederick W. Files.)

Q. That is, there is not a sale to your knowledge of \$3,074.74 nor of \$22,935?

A. Not recorded in the books of the corporation, no, sir.

Q. Do you recall whether or not the corporation recorded a sale to the Valley Boulevard Plumbing and Electric Company for which there was received \$12,000 in either cash or by check?

A. No, sir. [139]

Q. Did you make any inquiry with respect to these items and with respect to the removal of the materials from the yard to Mr. Clark?

A. Yes, sir.

Q. What did you ask Mr. Clark?

A. I first asked him if it was all right. He said he was handling the deal, for me not to be concerned with it.

The Court: Was there anything further said?

The Witness: No, sir.

Q. (By Mr. Machtinger): To your knowledge, Mr. Files, was Mr. Clark aware that these sales were not being recorded on the books and records of the corporation? A. Yes, sir.

Q. How do you know that he was so aware?

A. Because Mr. Clark was familiar with the corporate books and how we made the entries and no entry was given to me or no data was given to me to enter on the books on this transaction.

Q. Did you ask him or point out to him that it should be entered on the books and records of the organization? A. Yes, I did.

(Testimony of Frederick W. Files.)

Q. And do you recall, as best you can, specifically what he replied?

A. He replied that this was a deal that he was handling [140] himself and was no concern of mine.

Q. Did you point out to him that the books and records would not reflect the true income of the corporation?

Mr. A. Baird: Just a moment, if your Honor please, this has been gone into and it has been asked and answered many times.

The Court: I think the last question is proper, Mr. Baird, unless you are willing to concede the facts in it.

Will you read that last question, please?

(Question read.)

Mr. A. Baird: I will withdraw my objection.

The Witness: Yes.

Q. (By Mr. Machtinger): What did he reply to you?

A. That it was a situation that he would take care of it, he would worry about it himself, it was no concern of mine.

Q. While you were with the organization, Mr. Files, did the organization ever dispose of any machinery or equipment or automobiles?

A. Yes, there were frequent transactions of that nature.

Q. How did the organization dispose of those? Were they sold? A. Some.

Q. And the others? [141]

A. Traded, maybe.

(Testimony of Frederick W. Files.)

Q. And did you keep an accurate record of the transfers of the corporate assets that were disposed of?

A. We had a complete record of the corporate assets on the books. Everything was set up and evaluated as closely as we could. Assets that were carried over from the proprietorship, such as office fixtures and furniture, had to be estimated, but any equipment that was acquired at a later date by the corporation was set up at its cost value.

Q. Were you supplied with the appropriate invoices or sales slips and proceeds from the sales of these assets so that you could make the proper entries in the books and records?

A. On some.

Q. Why do you qualify that statement, Mr. Files?

A. Because on some of them I wasn't. I was simply handed a check and told to remove certain assets from the books, the proceeds of the check.

Q. Did the check that you were handed ever represent a payment for plumbing supplies purchased from the organization?

A. Could have been.

Q. Do you recall, to the best of your knowledge, whether a check was ever handed to you which was in payment of plumbing supplies of the organization and which check you applied against the sale of the corporate assets?

A. I can't recall any specific instrument, no.

Q. Do you recall, Mr. Files, a sale of an auto-

(Testimony of Frederick W. Files.)

mobile to the Las Vegas Plumbing and Supply Company?

A. I recall the name, Las Vegas Supply or Las Vegas Plumbing and Supply.

Q. Do you recall whether or not the Las Vegas Plumbing and Supply ever purchased plumbing supplies from the Gene Clark organization?

A. I believe that I was offered a sale or a check or something to that effect, some slip, a memorandum. I can't recall the exact details.

Q. Do you recall whether or not a cash receipt from the Las Vegas Supply Company was ever applied to remove a Chevrolet pick-up truck, 1947 Chevrolet pick-up truck?

A. I can recall that, yes, sir.

Mr. Machtinger: That is all the questions I have of this witness on direct.

Mr. A. Baird: Just one moment.

The Court: Mr. Baird, I don't insist upon this, I mean, normally I wait until both direct and cross examination of a witness is concluded before I ask any questions, but there are a few questions I would like to ask this witness concerning which you may want to cross examine him and if you haven't any objection, I would like to do it now. I don't mean that you are waiving objections to the questions, but to the time.

Mr. A. Baird: We have no objection. [143]

The Court: All right. Mr. Files, after the corporation was organized, were there any books of ac-

(Testimony of Frederick W. Files.)

count kept as to transactions of Gene Clark Plumbing, insofar as you know?

The Witness: No.

The Court: Was there anyone in charge of the books at the plant or office except you?

The Witness: No.

The Court: Were there any books for any period subsequent to the organization of the corporation except for closing out the proprietorship in the office or wherever the books were kept of Gene Clark, Inc.?

The Witness: The only book that was kept in the office that had any connection with Gene Clark Plumbing was a check book on the Bank of America in El Monte.

The Court: Were the employees in and about the office who worked on the books under your direction?

The Witness: Those that worked on books, partially under my direction.

The Court: Were there any that weren't at least partially under your direction?

The Witness: No, sir.

The Court: Did any of them work for Gene Clark Plumbing so far as you know?

The Witness: No, sir.

The Court: Were any of them paid for services to [144] Gene Clark Plumbing so far as you know?

The Witness: No, sir.

The Court: Were there any transactions relating

(Testimony of Frederick W. Files.)

to Gene Clark Plumbing which went on the books of the corporation?

The Witness: No, sir.

The Court: Were you paid by Gene Clark Plumbing after the corporation was formed?

The Witness: No, sir.

The Court: Beyond perhaps a few days of overlap?

The Witness: No, sir.

The Court: Was there ever any circumstance or account or transaction which came to your attention relating to Gene Clark Plumbing subsequent to the formation of the corporation other than such matters as were necessary to close out Gene Clark Plumbing?

The Witness: No, sir.

The Court: All right, go ahead.

Cross Examination

Q. (By Mr. A. Baird): Mr. Files, with reference to the inventory that was taken over by Gene Clark, Inc., in May of 1946, can you give us any estimate or any idea as to the amount of inventory of supplies that was in the yard as of that time?

A. No, sir.

Q. Would you say that it was more than \$20,000 or nearer [145] \$100,000.

A. I couldn't say.

Q. Well, Mr. Files, isn't it a fact that the corporation was incorporated for about \$52,000?

A. I believe those are the figures, yes.

(Testimony of Frederick W. Files.)

Q. And isn't it true that in addition to certain trucks and necessary operating equipment that an additional amount representing material and supplies of approximately \$19,000-odd dollars was set up on the books as the inventory, your starting inventory?

A. I don't recall the balance sheet for the opening entries. I don't recall what the figures were.

Q. Would you say that the entire stock of supplies and material which was there in the yard on May 1st, 1946 when the corporation started business was included in the inventory?

A. To the best of my knowledge, it was, yes. We were handed—Mr. Kay and I were handed an inventory purported to be the entire inventory.

Q. Purported to be the entire inventory and if that represented only the inventory that was intended to be the inventory of the corporation, it nevertheless could be true that there was other material and other supplies that were not included in that statement? A. It could be.

Q. Isn't it true that during all of this period about [146] which you have been talking that people were constantly making checks to about three different units, that is the records so far show that we have checks coming to Gene Clark, that we have checks coming to Gene Clark Plumbing and that we have checks coming to Gene Clark, Inc.?

A. Yes.

Q. And didn't that state of confusion become so great that it was necessary for you to adopt a rub-

(Testimony of Frederick W. Files.)

ber stamp which you ultimately used on your checks in which you included, I believe, all three, or at least two, of those designations?

A. All three.

Q. So you could stamp any check?

A. All three, sir.

Q. And that was used throughout the entire period? A. Yes, sir.

Q. If this business was solely the business of Gene Clark, Inc., why was it necessary for you to adopt a rubber stamp that would incorporate transactions of Gene Clark individually or Gene Clark Plumbing?

A. That's true in any business, sir, that has the word "Inc." tacked on the end. Gene Clark was an individual, and when a contractor got an invoice from Gene Clark, Inc., he might write a check to Gene Clark Plumbing, he might write it to Gene Clark, or he might remember to write the words "Inc." on the end of it and he'd send it along, and I talked with the [147] bank, and they suggested the composite stamp, just stamp your deposits with your stamp and that will take care of all of them.

Q. Mr. Files, you were present prior to the time that Archie Koyl and Gene Clark formed the Gene Clark, Inc. corporation? A. Yes.

Q. And are you at all familiar, personally familiar, with the arrangement which they had relative to either salaries or division of profits prior to the time that the corporation was formed?

A. No. You mean for the proprietorship?

(Testimony of Frederick W. Files.)

Q. For the proprietorship, if we call it a proprietorship.

A. Well, during the period of the proprietorship, it was my understanding after all expenses, et cetera, were paid, Mr. Koyl was to share equally with Mr. Clark, but I don't know as a positive fact, just my general understanding.

The Court: May I interrupt a minute. Off the record.

(Discussion off the record.)

Q. (By Mr. A. Baird): Mr. Files,—

The Court: I might say this, Mr. Baird, I don't know what your contention may be beyond the year 1946. I don't recall the details of the opening statement, but in effect, it [148] was that Gene Clark Plumbing continued on as an operating organization. So far as I see at the moment, the schedule in 1946 has no particular dates in it. It purports to cover the year. So far, I haven't seen anything for subsequent years relating to any plumbing business as a separate organization, a good deal with respect to farms and so forth. I merely call that to your attention for whatever it may be worth.

Mr. A. Baird: Thank you, your Honor.

Q. (By Mr. A. Baird): Mr. Files, did you have anything to do with the making of the returns of Gene Clark, Inc. and Gene and Faye Clark, individually?

A. With considerable outside help, yes, sir.

Q. I notice on the 1946 return in Schedule 1, which has been introduced in evidence as Exhibit—

(Testimony of Frederick W. Files.)

if the Clerk will give me the exhibit number——

Mr. T. Baird: 53.

Mr. A. Baird: Exhibit 53. The individual return of Gene Clark for the year 1946, is that the correct number?

The Clerk: Yes.

Q. (By Mr. A. Baird): I notice that Schedule 1 of that return indicates wages received from Gene Clark, Inc., \$11,999.95, and income from business, Schedule 2, \$18,827.60. Can you tell us what that income from business was? [149]

A. Is this the individual return of Gene Clark's or is it the corporation one?

Q. No, this is the individual return.

A. I had nothing to do with his individual returns.

Q. You had nothing to do with the individual returns? A. No.

Q. Did you furnish the accountants who made the returns the data or information from which the returns were made?

A. In this particular instance, this was the calendar year '46, filed in '47.

Q. That is correct.

A. That information would have been furnished by Gene on his request or any authorized representative of his.

Q. Do you recall now anything about income that Gene Clark had in 1946, other than what he got in the way of wages from Gene Clark, Inc.?

A. Well, yes, if there was a close-out of proprie-

(Testimony of Frederick W. Files.)

torship to a corporation, there would have been wages from the corporation and income from the proprietorship in the same year.

Q. And it is also possible, is it not, that he might have had income from some other sources?

A. Yes.

Q. Now——

Mr. A. Baird: May I have the corporation income tax returns of Gene Clark, Inc., Mr. Clerk?

Q. (By Mr. A. Baird): While we are finding those, I will go on to something else.

Mr. Files, you have testified on direct examination that on certain occasions Mr. Clark would turn in a check to you and ask you to cash the check, and you would take the cash out of the safe or out of the cash box and give him the cash. A. Yes.

Q. Do you know whether or not he used that cash that he received from you in connection with his own personal private affairs or do you know whether or not he used it for the purchase of material for Gene Clark, Inc.?

A. I don't know what he did with it.

Q. Mr. Files, isn't it true and wasn't it a matter of common knowledge, I might say to the public generally in this area and more particularly to the administrative officers of Gene Clark, Inc., that plumbing materials were exceedingly scarce and that to operate a plumbing business during that period of time with which we are here concerned, that it was necessary on occasion and frequent occasions to pay cash? A. Yes.

(Testimony of Frederick W. Files.)

Q. In order to obtain material? A. Yes.

Q. And wasn't it a matter of common knowledge to you, Mr. Files, that rather extensive payments in cash were made to [151] a supplier in Tyler, Texas by the name of Mike Harvey?

A. I was so informed.

Q. And isn't it also true, Mr. Files, that you received invoices from the Mike Harvey organization, whatever the name of their corporation was, for materials that they had sent Gene Clark, Inc. and for which you sent them your check or your draft? A. That's right.

Q. So, if I understand the picture correctly, you would get a consignment of goods from Tyler, Texas, would receive an invoice for a specified amount, and would remit to them your check for that amount?

A. Most of the shipments were handled—all of them were handled on sight drafts bill of lading, but that is substantially correct.

Q. And that at the same time, contemporaneously with that transaction, at or about the same time, that there would be a substantial cash payment made to Mr. Harvey or his representatives?

A. That was my understanding, yes, sir.

Q. That was a matter of common discussion and talk in the office between you, Mr. Koyl, and Mr. Clark, was it not? A. Yes, sir.

Q. Will you tell us whether or not the cash payments thus made were included on your books as a

(Testimony of Frederick W. Files.)

part of the cost of [152] the cost of purchases of material?

A. No, sir, I only recorded what the invoice freight would amount to. [153]

* * * * *

Q. Very well, but you have testified that on occasion Mr. Clark would come to you and get cash, and you have testified that you didn't know what he did with the cash? A. Right.

Q. And, if I understand you correctly, you have stated that it was the general understanding that Mr. Clark paid cash, the over-ceiling amount of the transaction, to Mike Harvey and others?

A. That is correct.

Q. So, in that round-about way, we could say, could we not, that it was corporation money?

The Court: Well, all this witness is saying, Mr. Baird, is that the cash so paid out was not paid out of recorded corporation funds. It's been made abundantly clear. I don't—well, nobody knows the amounts, certainly, at this moment. It's been made abundantly clear that they made a lot of cash purchases and that the funds that were used were not on the corporation's books. It's also been made abundantly clear that they made a lot of sales and took in a lot of cash that wasn't recorded on the corporation's books and those funds or substituted funds or any funds might have been used.

All this witness is saying is that whatever that cash was that was paid out didn't come out of funds which he had recorded as corporate funds.

(Testimony of Frederick W. Files.)

Mr. A. Baird: Very well. [154]

Q. (By Mr. A. Baird): Mr. Files, to pursue another phase of the situation, I will ask you if it wasn't necessary and if, in fact, you didn't engage in transactions during this period wherein your company would exchange with some other dealer or some competitor, perhaps, certain material which you had which you didn't need quite as bad as some other material which your competitor had and that there would be an exchange of a quantity of material of one kind for a quantity of material of another kind? A. Yes.

Q. So that when you testified on direct examination a while ago that there would be goods going out of the yard for which you made no account, I'll ask you if that encompassed some of these transactions, these trading transactions?

A. Those trading transactions were generally items of, most of the time, not always, items of general knowledge in the office. Some plumber would call up and say, "I've got a righthand tub, you got a left-hand?" and they'd swap, and everybody would know about it. The yard boy would have to know about it. Sometimes there was even papers exchanged, sometimes.

Q. But there were instances, if I understand the statement you made to me during the recess, where there would be no records made of these transactions at all? A. That is correct, sir.

Q. With reference to the so-called cash transactions, [155] where checks were cashed, I under-

(Testimony of Frederick W. Files.)

stood your testimony on direct examination, some of those might relate to customers of Gene Clark, Inc. and other checks might be checks that had no relationship to a customer of Gene Clark, Inc.?

A. Could have been instances of which there was no relationship, yes.

Q. If I remember correctly in your testimony the other day, didn't you state that there were accommodation checks? A. Yes.

Q. And that that was a regular, more or less regular procedure at your place of business?

A. Yes.

Q. Where you were accommodating, I believe, the cleaning establishment or the market or others?

A. That's correct.

Q. Workmen who had salary checks?

A. Yes.

Q. And the like? A. Yes.

The Court: Were they comparatively large or small denominations?

The Witness: Relatively small, in sums ranging around a hundred dollars, your Honor.

The Court: All right, go ahead. [156]

Q. (By Mr. A. Baird): But those checks would go in with the other cash that you had received?

A. Yes.

Q. Do you know whether or not Mr. Clark kept any record, aside from what you call the records and books of the corporation, of the amounts that he had paid to Mike Harvey or others with whom he was dealing in cash?

(Testimony of Frederick W. Files.)

A. I don't know of any such records, no, sir.

Q. Did you ever see any such record?

A. No, sir.

Q. Did you ever ask him whether he had any such records?

A. I don't recall, sir.

Q. Wasn't it true, Mr. Files, that on some occasions that some of the people with whom you were dealing in cash insisted that there be no record made on your books or on their own?

A. I don't recall any specific instance of such.

Q. Wasn't that true with reference to the Keenan Pipe and Steel Company dealings that you and Mr. Koyl had with Fred Keenan?

A. I had no dealings with Fred Keenan.

Q. I believe Mr. Koyl had.

A. Yes.

Q. I do not know whether you can answer the question or not. [157]

A. Well, I have lost it now, sir. Would you——

Q. Let me ask again. Do you know whether or not there was any arrangement whereby it was agreed that the transactions between Gene Clark, Inc. and Keenan Pipe and Steel would be on a cash basis with no record made?

A. Yes, I knew of that arrangement, yes, sir.

Q. There was such an arrangement?

A. Yes, sir.

Q. And that was in existence during what period of time?

A. I first became aware of it early in '47, I believe.

Q. And that continued on through?

(Testimony of Frederick W. Files.)

A. Well, it continued on through '47, but there was no such arrangement to my knowledge in '48, resumed again in '49.

Q. Resumed again in '49? A. Yes.

Q. That is, during the year '48 when Mr. Koyl was away, there was no such arrangement?

A. Not to my knowledge, sir.

Q. Now, coming to another phase of this situation——

Mr. A. Baird: I may say that this may not be proper cross examination, but I will be glad to make the witness my own witness if it is in order and as a matter of accommodation to him. I do want to inquire something about the entries on the books and records with reference to notes receivable account and the trust deed account. [158]

The Court: Any objection?

Mr. Machtinger: No objection, your Honor. Go ahead. [159]

* * * * *

Q. (By Mr. A. Baird): Now, Mr. Files, there has been some testimony given in the case in which you appeared as a witness here earlier in the week, and while you are here I want to get you as the accountant to explain to us certain entries on the books which has to do with the acquisition of certain farm land in Kansas.

Now, I will show you first a notes receivable sheet from your journal ledger bearing the date 1946 and ask you, if you can tell us, what those entries relate to?

(Testimony of Frederick W. Files.)

A. It appears to be a general notes receivable account. However, I made none of these entries personally.

Q. Were they made under your supervision?

A. No.

Q. Can you tell us whether or not the particular page to which I am referring—this doesn't seem to have a page number on it, but it bears the date in the upper left-hand corner of 1946—as to whether or not that relates to notes receivable of the officers?

A. I am not certain, sir, the general ledger page such as this would not have a page number. The account number serves as the page number as well as an account number.

Q. Well, you see, I am not an accountant, so I wouldn't know that. At any rate, without some further analysis or [160] inspection, you cannot tell us at this time whether the entries on that page relate solely to accounts receivable from officers?

A. Well, I know that all of them don't. I recognize some entries.

Q. Do you know whether or not some of them do?

A. Yes. I can see one entry labeled West Covina, Journal Entry No. 19, in the amount of \$4,270. I believe that that pertained to the piece of property on Vine Avenue, but I would like to see the journal entry.

Q. That may not be important for our purpose at the moment. In connection with the acquisition

(Testimony of Frederick W. Files.)

of farm property down in Kansas, were you present at the time that it had been determined, or at least there was consideration given, to having the corporation acquire farm property in Kansas?

A. Yes.

Q. And were you with the organization at the time it was determined to reverse the field, so to speak, and acquire those properties for the individual officers? A. Yes.

Q. Did the corporation as such ever own any farm land in Kansas?

A. We tried to. I don't know if we owned it or not. I believe that we never were actually registered owners in Kansas, but I don't know.

Q. Do you recall whether or not you received some advice, [161] and when I say "you," I mean the officers of your company, from an attorney in Kansas to the general effect that you either could not own or could not operate farm lands in Kansas, a California company? A. Yes.

Q. There was some such legal advice obtained?

A. Yes.

Q. Can you look at the ledger sheets or the journal or wherever you would find it entered here and tell us whether or not there were any amounts advanced to Archie Koyl and Gene Clark for the acquisition of property down in Kansas?

A. On page 59 of the general journal under dates of April 30th, there is an entry regarding——

Q. What year?

(Testimony of Frederick W. Files.)

A. 1948—there is an entry regarding this transaction.

Q. And what is that entry?

A. It is a debit, cash on hand, and a credit to accounts receivable, officers, in the amount of \$20,000, to record the payment of \$20,000 on notes receivable, officers, by Mr. Gene Clark.

Q. With reference to that \$20,000 payment by Mr. Gene Clark, I will ask you if that \$20,000 wasn't the dividend which he received from Gene Clark, Inc. in 1948?

A. Yes, it was. The following entry explains that.

Q. In other words, he received a dividend in 1948 from [162] the corporation and turned it over to the corporation in partial payment of the notes receivable standing on the corporation's books?

A. That's correct.

Q. Do you know whether or not at the time—well, first let me ask you, that left a balance due from Gene Clark to the corporation as of that time of how much? A. \$27,518.99.

Q. Will you tell us, please, if you know, whether or not that amount was paid by Gene Clark and, if so, in what manner?

A. This entry is on the books, still on the books when I left the corporation.

Q. And when did you leave the corporation?

A. In July of '49.

Q. When you say it was still on the books, you mean that there was an account receivable on the

(Testimony of Frederick W. Files.)

books showing that the corporation was entitled to \$27,518 from someone and it had not been paid?

A. That is correct.

Q. Do you know whether or not in the negotiations made by Gene Clark with Archie Koyl at the time that Mr. Koyl re-purchased stock in the Gene Clark, Inc., in fact, all of the stock, that as a part of the deal Archie Koyl agreed to assume the liability of \$27,518.99? [163]

A. I don't recall the exact legal phrasing of the documents or anything like that. I know that it said there it remained on the books.

Q. Do you have any general understanding as to whether or not as a part of their deal Koyl was to assume Clark's liability to the corporation for that amount?

A. Do I have knowledge that he was supposed to?

Q. Yes. A. I don't recall.

Q. I notice with reference to the general ledger, it being general ledger Account No. 110, which reflects the item \$27,518.99 to which you have referred, which is the balance after the \$20,000 dividend had been applied against Clark's indebtedness of \$27,518.99, that you or someone have changed the heading on that ledger sheet from notes receivable, officers, to trust deeds. I will ask you whether or not that change was made by you?

A. No, sir.

Q. Is the heading, notes receivable, officers, which has been stricken out in your handwriting?

(Testimony of Frederick W. Files.)

A. No, sir.

Q. You did not make that entry?

A. No, sir.

Q. Were you, as controller of the company, familiar with the fact that you had an account of that kind on the books? [164]

A. Yes, sir.

Q. Do you know who made this change and for what reason that change of title was made?

A. Mr. Kay made that change in making certain closing entries at the end of the fiscal year. You will note the date.

Q. April 30, Mr. Kay made the change. Mr. Files, to your knowledge—I will withdraw that question.

A Ledger account headed trust deeds would indicate, would it not, that the corporation was the owner of certain trust deeds?

A. Yes.

Q. I will ask you whether or not to your knowledge the corporation ever owned any trust deeds of any kind from Kansas property or property elsewhere?

A. I never saw any.

Q. And is there any reason why you, as the controller and general business administrative officer of the company, would not have had the trust deeds in your custody and under your care if there were any in existence?

A. I should have had them, they were constantly promised to me, but I never got them.

Q. So that at the time that Gene Clark sold out to Archie Koyl this company didn't own any trust deeds, did it?

A. Not to my knowledge.

(Testimony of Frederick W. Files.)

Q. And the books and records do not indicate that it [165] owned any?

A. Except under the heading of this account.

Q. Except under the heading of this account which is written off, which was originally notes receivable?

A. That is correct, sir.

Q. I will ask you to look under the heading of the account as now changed, trust deeds, and see if there is anything on there to indicate that the company had any trust deeds?

A. No, sir, that is just an account title.

Mr. A. Baird: Mr. Machtinger, in the interest of saving time, will you stipulate that we may at the appropriate time introduce photostats of the minutes of the corporation?

Mr. Machtinger: Yes, at the appropriate time, if there is such an appropriate time.

Mr. A. Baird: I don't want to dismiss this witness and then not be able to identify them.

Mr. Machtinger: I want it to be clear that if it is in my opinion not an appropriate time, I will make such an objection.

The Court: Are the minutes here?

Mr. A. Baird: The minutes are here, yes.

The Court: Can he identify them generally? I don't know if what you are going to offer would be either material or timely or what, but why can't we settle whether they are the minutes? [166]

Mr. A. Baird: We have the minute books, your Honor, and we have made photostats of certain portions that might be pertinent.

(Testimony of Frederick W. Files.)

The Court: It seems to me you and Mr. Machtinger could get together on it. So far as this witness is concerned, it seems to me that there may be chances that he is going to be required. I have no objection to him being excused but I think it ought to be conditioned on the fact that counsel know where he is going to be and can call him, if necessary, upon reasonably short notice.

How far are you from this courthouse?

The Witness: It's San Gabriel, sir, on the freeway, about 30 minutes.

The Court: This case is going along to a point now where we want to conclude it, and witnesses must, to some extent, sacrifice their interests because some day they may be in the same position and need other witnesses.

Mr. Machtinger: I will stipulate.

The Court: Have you finished with this witness, Mr. Baird?

Mr. A. Baird: No, I have one more question.

Q. (By Mr. A. Baird): Mr. Files, I show you a joint exhibit, 12-L, which is the corporation income tax return of Gene Clark, Inc. for the fiscal year 1946, ending—fiscal year 1947, ending April 30, [167] 1947, to which exhibit there is attached a claim for refund bearing the signature Frederick W. Files, secretary-treasurer. I will ask you if that is your signature and if you prepared that claim for refund? A. Yes, sir, I did.

Q. And the date on that claim is what?

A. 27th. You mean under the notarization?

(Testimony of Frederick W. Files.)

Q. Yes. A. 27th of June, 1949.

Q. And can you tell us whether or not on the basis of that claim your company received a refund?

A. I don't really know whether they ever got the refund, sir. I was not with the company then.

Q. I now show you a joint exhibit, 13-M, which is the corporation income tax return for the fiscal year ending April 30, 1948 and ask you whether or not that return was prepared under your supervision and whether it bears your signature as controller?

A. It bears my signature as controller. It was prepared jointly by Mr. Kay and myself from the books and accounts and taken, I believe, to Mr. Hicks in Compton for checking and supervision of the entries and so forth and so on.

Q. And this return for that year was filed in the Director's office on July 14, 1948?

A. Purports to be from that stamp, yes, sir.

Q. I show you Joint Exhibit 14-N, which is a corporation income tax return of Gene Clark, Inc. for the year ending April 30, 1949.

A. Yes, sir.

Q. And ask you whether or not your signature appears there as an officer on that return, Frederick W. Files, treasurer? A. It does.

Q. That is your signature? A. Yes, sir.

Q. And did you prepare that return or was it prepared under your supervision?

A. Together with Mr. Kay, and I don't—yes, I

(Testimony of Frederick W. Files.)

don't recall whether or not we took this one to Mr. Hick's office or not. Mr. Kay and I prepared the return.

Q. I notice that that return was signed by Archie Koyl as president?

A. That is correct, sir.

Q. What, if anything, did Gene Clark have to do with the preparing of this return for the fiscal year 1949?

A. Mr. Clark had no concern with that return.

Q. He had no concern with it? A. No, sir.

Q. As a matter of fact, he wasn't with the company at that time? [169]

A. That is correct, sir.

Q. Do you know whether he was here or whether he was in Kansas? A. I don't recall.

Q. Mr. Files, with reference to the cash sales that were made out of the office, were those records that were made, were they made on regular corporation books or were they made on little scraps of paper or pads or how was that handled?

A. We just used a cheap ready form book of sales tickets consisting of an original and a duplicate and a carbon intersert and we bought at the store a dozen or so at a time. No concern was paid to numerical sequence or anything.

Q. That is all, Mr. Files.

Mr. Machtinger: Just a few questions, if I may, Mr. Files.